SHUMAKER
Shumaker, Loop & Kendrick, LLP

M&A Brokers Update

By: Regina M. Joseph

Brokers that facilitate the purchase and sale of privately held companies usually seek to be compensated by a percentage of the transaction value if the transaction is consummated. For a transaction structured as a sale of equity securities, payment of transaction-based compensation is usually problematic under federal and state securities law. This is because such activity has traditionally been seen to fall within the definition of a "broker," requiring burdensome registration as a broker-dealer.

This view may be changing, at least at the federal level.

On January 15, 2014, the U.S. House of Representatives passed H.R. 2274: Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2013. The Bill was referred to a Senate Committee, where it remains as of this writing. H.R. 2274 amends Section 15(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") to exempt from registration brokers performing services in connection with the transfer of ownership of smaller privately held companies. An M&A broker is not exempt from registration if it (a) takes custody of funds or securities for exchange, or (b) facilities a public offering of securities. For definitions and the complete text, please see https://www.govtrack.us/congress/bills/113/hr2274/text.

Although the Securities and Exchange Commission ("SEC") did not enthusiastically receive 2013 legislation loosening regulation of private offerings and crowdfunding, the SEC has apparently changed its view of M&A brokers. In a No-Action Letter released January 31, 2014 and revised February 4, 2014 (referred to in its letters listing as "M&A Brokers"), the SEC Division of Trading and Markets stated that it would not recommend enforcement action if an M&A Broker were to effect securities transactions in connection with the transfer of ownership of a privately-held company under the terms described in the letter without registering as a broker-dealer pursuant to Section 15(b) of the Exchange Act. The SEC noted the following representations upon which it relied (summarized):

1. The M&A Broker may not bind a party to an M&A Transaction.
2. The M&A Broker will not provide financing or assist purchasers in obtaining financing.
3. The M&A Broker will not have custody or control over exchanged funds or securities.
4. No M&A Transaction will involve a public offering.
5. If an M&A Broker represents both buyer and seller, it will disclose and contain written consent to the joint representation.

6. An M&A Broker will facilitate an M&A Transaction with a group of buyers only if the group is formed without the assistance of the M&A Broker.
7. After the closing, the buyer will control and actively operate the acquired business.
8. The acquired business will not be sold to a group of passive investors.
9. Any securities received by the M&A Broker in an M&A Transaction will be restricted securities within the meaning of federal securities laws.
10. The M&A Broker and its officers, directors and employees have not been (i) barred from association with a broker-dealer by the SEC or any state or self-regulatory organization; nor (ii) suspended from association with a broker-dealer.

The pdf of the SEC's M&A Broker letter may be obtained at www.sec.gov or from the author at rjoseph@slk-law.com

Will state regulators follow suit? State regulators and their industry association, the National Association of Securities Administrators ("NASAA"), have traditionally opposed any loosening of the private offering rules and their authority over such offerings. However, they may be less opposed to loosening restrictions on M&A Brokers. In October 2013, NASAA's immediate Past President, A. Heath Abshure, testified before the House Committee on Financial Services Subcommittee that, "State securities administrators generally support the targeted, well-balanced provisions of H.R. 2274 . . . . The legislation would establish a simplified and streamlined registration process for broker-dealers engaged solely in the business of effecting the transfer or sale of private held companies. . . . NASAA is optimistic that this legislation will encourage registration and regulatory compliance by M&A brokers. (http://www.nasaa.org/27276/legislation-reduce-impediments-capital-formation/) Of course, H.R. 2274 in its present form exempts M&A Brokers; it does not contain a simplified registration process.

For additional information, please contact:

Regina M. Joseph
Shumaker, Loop & Kendrick, LLP
1000 Jackson Street
Toledo, OH 43604-5573
Direct: 419.321.1435
Fax: 419.241.6894
rjoseph@slk-law.com
www.slk-law.com