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SEC Offers Guidance to Business Brokers

Although the trend in recent no-action letters involving finders seems to reflect a hardening of the SEC staff's position that rarely is a finder not required to register as a broker-dealer, there is more positive news to report in connection with business brokers.

In January 2014, six M&A attorneys sought no-action relief from the SEC staff when the seller of a business engaged a business broker to facilitate the transaction. In particular, the requesting parties sought assurance that the business broker would be able to advertise a privately held company for sale with information such as the description of the business, general location, and price range without registering as a broker-dealer.

The letter noted that the registration issue became more acute after the 1985 *Landreth* decision in which the U.S. Supreme Court found the sale of a privately held company in a stock sale involved a securities transaction. The letter pointed out the anomalous result that the securities implications of the sale of a business were being determined by whether the sale was structured as a sale of assets or stock, a decision generally based on accounting or tax considerations. Moreover, the parties to the sale usually negotiate how to structure the transaction long after the business broker has completed its engagement to identify potential purchasers.

In the *Faith Colish* no-action letter issued on January 31, 2014, the SEC staff granted the requested assurance that an "M&A Broker" who conducted its activities within certain parameters would not be required to register as a broker-dealer.

An "M&A Broker" was defined as a person engaged in the business of effecting securities transactions *solely* in connection with the transfer of ownership and control of a privately held company through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the company, to a buyer that will actively operate the company or the business conducted with the assets of the company.

A “privately held company” means an operating company, without regard to size, that is a going concern and not a “shell” company, which:

- does not have any class of securities registered, or required to be registered, under Section 12 of the Securities Exchange Act of 1934 (“Exchange Act”), and
- does not file, nor is required to file, periodic information, documents, or reports under Section 15(d) of the Exchange Act.

In issuing its no-action letter, the SEC staff noted the following representations made by the requesting attorneys, which are, in effect, the conditions on which a business broker may conduct its business without registering as broker-dealer.

- The M&A Broker will not have the ability to bind a party to an M&A Transaction.
- An M&A Broker will not directly, or indirectly through any of its affiliates, provide financing for an M&A Transaction. An M&A Broker that assists purchasers to obtain financing from unaffiliated third parties must comply with all applicable legal requirements, including, as applicable, Regulation T (12 CFR 220 *et seq.*) and must disclose any compensation in writing to the client.
- Under no circumstances will an M&A Broker have custody, control, or possession of or otherwise handle funds or securities issued or exchanged in connection with an M&A Transaction or other securities transaction for the account of others.
- No M&A Transaction will involve a public offering. Any offering or sale of securities will be conducted in compliance with an applicable exemption from registration under the Securities Act of 1933 (“Securities Act”). No party to any M&A Transaction will be a shell company, other than a business combination related shell company.
- To the extent an M&A Broker represents both buyers and sellers, it will provide clear written disclosure as to the parties

it represents and obtain written consent from both parties to the joint representation.

- 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.
- The buyer, or group of buyers, in any M&A Transaction will, upon completion of the M&A Transaction, control and actively operate the company or the business conducted with the assets of the business.

(i) A buyer, or group of buyers collectively, would have the necessary control if it has the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise.

(ii) The necessary control will be presumed to exist if, upon completion of the transaction, the buyer or group of buyers has the right to vote 25% or more of a class of voting securities; has the power to sell or direct the sale of 25% or more of a class of voting securities; or in the case of a partnership or limited liability company, has the right to receive upon dissolution or has contributed 25% or more of the capital.

(iii) A buyer could actively operate the company through the power to elect executive officers and approve the annual budget or by service as an executive or other executive manager, among other things.

8. No M&A Transaction will result in the transfer of interests to a passive buyer or group of passive buyers.

9. Any securities received by the buyer or M&A Broker in an M&A Transaction will be restricted securities (within the meaning of Rule 144 under the Securities Act) because the securities would have been issued in a transaction not involving a public offering.

10. The M&A Broker (and, if the M&A Broker is an entity, each officer, director or employee of the M&A Broker):

- (i) has not been barred from association with a broker-dealer by the commission, any state or any self-regulatory organization; and
- (ii) is not suspended from association with a broker-dealer.

The *Faith Colish* no-action letter is limited to the broker-dealer registration requirements of the Exchange Act. The SEC staff noted that other provisions of federal securities laws continue to apply, noting specifically anti-fraud provisions.

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