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M&A Brokers and Transaction-Based Compensation

February 5, 2014

The Division of Trading and Markets of the Securities and Exchange Commission has issued a no-action letter that will be of interest to persons that act as brokers for merger and acquisition transactions. The letter provides that the Division would not recommend enforcement action to the SEC against an M&A Broker if the M&A Broker limits its activities to those specified in the letter and its activities otherwise comply with the conditions described in the letter.[1]

For purposes of the letter, an "M&A Broker" is 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.

In summary, a person may act as an M&A broker and receive transaction-based compensation in connection with the purchase or sale of a privately held company (including a transaction structured as the sale of stock) without registering as a broker-dealer pursuant to Section 15(b) of the Securities Exchange Act, if the following conditions are satisfied:

1. The M&A broker will not have the ability to bind a party to the transaction.

2. The M&A broker will not directly, or indirectly through any of its affiliates, provide financing for the transaction.

3. The M&A broker may not have custody or otherwise handle funds or securities issued or exchanged in connection with the transaction or other securities transactions for the accounts of others.

4. The transaction does not involve a public offering. No party to the transaction may be a shell company, other than a “business combination related shell company” (i.e. a newly formed merger subsidiary).

5. If the 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.

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[1] No-Action Letter to Faith Colish, Esq., Martin A. Hewitt, Esq., Eden L. Rohrer, Esq., Linda Lerner, Esq., Ethan L. Silver, Esq., and Stacy E. Nathanson, Esq. dated January 31, 2014 [Revised: February 4, 2014].

6. The M&A broker will facilitate a transaction with a group of buyers only if the group is formed without the assistance of the M&A broker.

7. The buyer, or group of buyers, will, upon completion of the transaction, control[2] and actively operate the company or the business conducted with the assets of the business.

8. The transaction will not result in the transfer of interests to a passive buyer or group of passive buyers.

9. The M&A broker (and, if the broker is an entity, each officer, director or employee of the broker): (i) has not been barred from association with a broker-dealer by the SEC, any state or any self-regulatory organization; and (ii) is not suspended from association with a broker-dealer.

The no-action letter is limited to M&A transactions of privately held companies and does not apply to persons, including "finders," that receive transaction-based compensation in connection with the offer and sale of securities in capital raising transactions.

In addition, persons acting as broker-dealers in connection with merger and acquisition transactions should be mindful of the need to comply not only with federal law but also with the laws of each state in which they are conducting business to determine whether or not their activities require them to be registered as broker-dealers under state law.

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[2] Control exists if the buyer, or group of buyers collectively, has the power, directly or indirectly, to direct the management or policies of a company and will be presumed to exist if, upon completion of the transaction, the buyer or group of buyers has the right to vote or sell 25% or more of a class of voting securities.