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NASAA Proposes Uniform State Model Rule Regarding Merger and Acquisition Brokers

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The North American Securities Administrators Association ("NASAA') has proposed a uniform state model rule that would exempt certain merger and acquisition brokers from registration pursuant to state securities laws. The proposal, if adopted by NASAA and subsequently implemented by the states, would complement recent initiatives at the federal level, including an SEC no-action letter issued last year that specified the conditions under which the SEC would not recommend enforcement action if an M&A broker did not register as a broker-dealer under the Securities Exchange Act of 1934.[1]

Merger and Acquisition Broker

Under the NASAA proposed model rule, a "Merger and Acquisition Broker" is a broker whose business is limited to effecting securities transactions in connection with the transfer of ownership of an "eligible privately held company" (whether structured as a sale of securities or assets). To claim the exemption the broker must reasonably believe that upon consummation of the transaction, the buyer will control and will be active in the management of the company. There is a presumption of control for any person has the right to vote 20% or more of a class of voting securities or the power to sell or direct the sale of 20% or more of a class of voting securities. In addition, if the consideration in the transaction includes securities, the broker must reasonably believe that the seller receives or has reasonable access to specified financial information concerning the issuer of the securities.

The proposed model rule would not exempt from registration any broker that (i) in connection with the transaction, receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties to the transaction, (ii) engages on behalf of an issuer in a public offering of any class of securities that is registered, or is required to be registered, with the SEC, or (iii) engages on behalf of any party in a transaction involving a public shell company. In addition, the exemption would not be available to any broker that has been subject to statutory disqualification or suspension.

[1] See SEC 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].

Eligible Private Company

As proposed, the exemption would be limited to transactions involving "eligible private companies." These are companies that do not have a class of securities registered under the Securities Exchange Act of 1934 and which, in the fiscal year prior to the fiscal year in which the Merger and Acquisition Broker is initially engaged, have earnings before interest, taxes, depreciation, and amortization of less than $25 million or gross revenues of less than $250 million.

Differences between NASAA Proposed Model Rule and SEC No-Action Letter

There are significant differences between the NASAA's proposed model rule and the conditions specified by the SEC in its no-action guidance last year:

- the SEC no-action letter contains no limit on the size of the acquired company whereas the proposed model rule would limit the exemption to transactions in which the acquired company has less than $25 million in EBITDA or less than $250 million in gross revenues.

- the presumption of control means at least a 20% voting interest in the company under the proposed model rule and 25% under the SEC no-action letter.

- if the consideration in the transaction includes securities, the SEC no-action letter does not contain a condition that the broker must reasonably believe that the seller receives or has reasonable access to specified financial information concerning the issuer of the securities.

These differences may be reconciled during the comment process but it remains to be seen whether this or any similar proposal proving an exemption from broker-dealer registration is implemented at the state level. If the model rule is approved by NASAA, the individual states must adopt the rule into their own securities laws before it would take effect. In the interim, persons acting as broker-dealers in connection with merger and acquisition transactions should be mindful of the need to check 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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