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M&A Brokers and Their Exemptions

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Status and Comparison of the SEC M&A Broker No-action Letter and H.R. 2274 – S. 1923 *the Small Business Mergers, Acquisitions and Sales Brokerage Simplification Act*

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Summary and Status Update

H.R. 2274, *the Small Business Mergers, Acquisitions, and Sales Brokerage Simplification Act of 2013*, and its identical Senate companion bill, S. 1923 (together, the *Bill*), would amend the Securities Exchange Act of 1934 (the *Exchange Act*), to create an exemption from federal broker-dealer registration for "M&A brokers" who facilitate mergers, acquisitions, sales, and similar transactions involving privately held companies. While H.R. 2274 unanimously passed the U.S. House of Representatives in 2014, the 113th Congress adjourned without the U.S. Senate acting on the Bill. It is anticipated the Bill will be reintroduced in 2015.

Two weeks after the Bill passed the U.S. House, the Securities and Exchange Commission (*SEC*) staff issued the "M&A Broker" no-action letter dated January 31, 2014, to six securities lawyers (the *NAL*). This NAL is generally available to any intermediary assisting with the transfer of a privately held company's ownership under its stated facts, circumstances, and conditions. Unlike most no-action letters, the application of this NAL is not limited to the persons requesting the guidance and relief. The SEC Division of Trading and Markets staff's letter concludes it would not recommend enforcement action if, without registering with the SEC as a broker-dealer, an M&A broker engages in covered activities if all of the NAL's conditions are satisfied.[1]

While, in effect, the NAL has granted similar exemptive relief to what the Bill would add to the Exchange Act, the NAL does not bear the authority of a rule or order officially adopted by the SEC's five commissioners, and so it is limited in its legal effect.[2] The NAL is effective today for M&A brokers who satisfy its stated facts, circumstances, and conditions unless and until the SEC staff—present or future—chooses to change its stated position. The SEC staff's position is not legally binding on a court and does not apply to state securities regulation.

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[1] For additional information about the background and substance of the NAL and the Bill, please refer to the attached article, *Simplifying Securities Regulation of M&A Brokers*, first published in the *Michigan Business Law Journal*, available at: http://www.michbar.org/business/BLJ/Spring2014/hansen.pdf.

[2] See the SEC's explanation of its no-action letters on its website at: http://www.sec.gov/answers/noaction.htm#.

The NAL and the Bill share fundamental public policy underpinnings, which is not coincidental because they share a common origin[3] and represent extensive discussions about M&A brokers that started in 2006 with the SEC staff and state securities regulators. Discussions with SEC staff about the terms of a possible no-action letter commenced on June 6, 2013, the same day as the Bill's introduction in the U.S. House. The NAL uses many terms and contains conditions that are the same or similar to those in the Bill. Notably, under both the NAL and the Bill, the target company must be privately held by the seller and, after the transaction's closing, the buyer must have acquired control and be actively involved in operating the business.[4] The definition of an "M&A broker", the types of covered M&A transactions, and, with the exception of its size, the definition of a "privately held company" are the same. "Control" concepts are the same but with slightly different presumption thresholds, as noted below. There are several notable differences.

Most differences between the NAL and the Bill arise from the inherently fact-specific nature of a no-action letter when compared to the general nature of a statutory amendment. A few substantive differences resulted from the timing of the Bill's introduction on June 6, 2013, and the NAL's release eight months later, as well as an amendment just prior to H.R. 2274's mark-up by the U.S. House Financial Services Committee. The SEC requested that the Committee modify the Bill to create a self-executing exemption, rather than requiring a simplified form of notice-filing registration as was initially proposed. This amended version of H.R. 2274 then unanimously passed the Committee (57-0) on November 14, 2013, and it unanimously passed the U.S. House (422-0) on January 14, 2014. Changes made to accommodate the SEC's request inadvertently deleted certain disqualifications, as noted below.

Comparison of the NAL and the Bill

- The NAL does not include any limitation on the size of a privately held company. Under the Bill the size of the target company was limited to being either: (i) less than $25 million in "earnings before interest, taxes, depreciation, and amortization" (commonly called EBITDA); and/or (ii) less than $250 million in gross revenues. The size was measured by the company's historical financial accounting records for the most recently completed fiscal year. The concept of a size limitation was included in the Bill in view of an earlier suggestion of the SEC staff.

- The NAL uses a 25% threshold to create a presumption of a buyer's acquiring control of the target company. This threshold is commonly used by the SEC in a variety of contexts such as reporting ownership in Form BD and when approval is required for a firm's change of control. The Bill uses a 20% threshold because the

[3] See the Report and Recommendations of the Private Placement Broker-Dealer Task Force of the Business Law Section of the American Bar Association, 60 Business Lawyer 959-1028 (2005) available on the SEC's website at www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf).

[4] These conditions are closely related to the public policy considerations articulated by the U.S. Supreme Court in *SEC v. Ralston Purina Co.*, 346 U.S. 119; 73 S. Ct. 981; 97 L. Ed. 1494 (1953).

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