To Our Clients and Friends

Memorandum

FRIED FRANK

friedfrank.com

SEC Provides Relief from Broker-Dealer Registration to Private M&A Brokers

In a significant departure from prior guidance, on January 31, 2014, the Division of Trading and Markets of the Securities and Exchange Commission ("SEC") issued a No-Action letter[1] that would permit a person giving advice on mergers and acquisitions transactions ("M&A Broker") to receive transaction-based compensation under certain conditions without having to register as a broker-dealer under Section 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act").

Background

The SEC's traditional position had been that M&A Brokers who provide advice concerning corporate acquisitions that result in the sale of securities and who receive transaction-based compensation generally were required to register as broker-dealers under the Exchange Act.[2] Registration required an arduous application process, membership with FINRA and the application of a myriad set of Exchange Act and FINRA rules that had only a tangential relationship to the business.

Definition of "M&A Broker"

In 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[3] 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.

Relief Granted

M&A Brokers that facilitate mergers, acquisitions, business sales, and business combinations (together, "M&A Transactions") between sellers and buyers of privately-held companies, without regard to the size

1 http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf

2 Although some relief was granted, see, e.g. *Country Business, Inc.,* SEC No-Action Letter (Nov. 8, 2006) and *International Business Exchange Corporation*, SEC No Action Letter (Dec. 12, 1986), these letters involved so-called business "finders," and were very limited in scope and were not widely relied upon.

3 A "privately-held company" for purposes of the letter is a company that does not have any class of securities registered, or required to be registered, with the SEC under Section 12 of the Exchange Act, or with respect to which the company files, or is required to file, periodic information, documents, or reports under Section 15(d) of the Exchange Act. Any privately-held company that is the subject of the letter would be an operating company that is a going concern and not a "shell" company.

of the privately-held companies, may engage in such activities, including advertising a privately-held company for sale, with information concerning a potential transaction, such as the description of the business, general location, and price range, and receive transaction-based compensation without being required to register as broker-dealers under the Exchange Act under the following conditions:

1. The M&A Broker will not have the ability to bind a party to an M&A Transaction.

2. 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.

3. Under no circumstances may 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 transactions for the accounts of others.

4. No M&A Transaction may 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 (the "Securities Act"). No party to any M&A Transaction may be a shell company, [4] other than a “business combination related shell company.”[5]

5. 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.

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. 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. 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.[6] In addition, the buyer, or group of buyers, must actively operate the company or the business conducted with the assets of the company.

---

[4] A "shell" company is a company that: (1) has no or nominal operations; and (2) has: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets. In this context, a "going concern" need not be profitable, and could even be emerging from bankruptcy, so long as it has actually been conducting business, including soliciting or effecting business transactions or engaging in research and development activities.

[5] The term "business combination related shell company" means a shell company (as defined in Securities Act Rule 405) that is: (I) formed by an entity that is not a shell company solely for the purpose of changing the corporate domicile of that entity solely within the United States; or (2) formed by an entity defined in Securities Act Rule 165(f)) among one or more entities other than the shell company, none of which is a shell company.

[6] 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.

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(a)(3) 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.

Conclusion

The guidance by the SEC staff in this letter represents a significant change in the SEC's historical position that the receipt of transaction-based compensation in connection with effecting a securities transaction requires broker-dealer registration, even in the context of a merger and acquisition transaction. Firms and individuals providing M & A advice within the confines of the letter's conditions no longer will have to register as broker-dealers in order to receive success fees in connection with their services.

* * *

Authors:

Jessica Forbes

Gregory P. Gnall

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or the attorneys listed below:

Contacts:

New York:

Jeffrey Bagner	+1.212.859.8136	jeffrey.bagner@friedfrank.com
Abigail Pickering Bomba	+1.212.859.8622	abigail.bomba@friedfrank.com
Andrew J. Colosimo	+1.212.859.8868	andrew.colosimo@friedfrank.com
Aviva F. Diamant	+1.212.859.8185	aviva.diamant@friedfrank.com
Steven Epstein	+1.212.859.8964	steven.epstein@friedfrank.com
Christopher Ewan	+1.212.859.8875	christopher.ewan@friedfrank.com
Jessica Forbes	+1.212.859.8558	jessica.forbes@friedfrank.com
Gregory P. Gnall	+1.212.859.8201	gregory.gnall@friedfrank.com
Peter S. Golden	+1.212.859.8112	peter.golden@friedfrank.com
David J. Greenwald	+1.212.859.8209	david.greenwald@friedfrank.com
Tiffany Pollard	+1.212.859.8231	tiffany.pollard@friedfrank.com
Philip Richter	+1.212.859.8763	philip.richter@friedfrank.com
Robert C. Schwenkel	+1.212.859.8167	robert.schwenkel@friedfrank.com
David L. Shaw	+1.212.859.8803	david.shaw@friedfrank.com
David N. Shine	+1.212.859.8284	david.shine@friedfrank.com
John E. Sorkin	+1.212.859.8980	john.sorkin@friedfrank.com
Steven J. Steinman	+1.212.859.8092	steven.steinman@friedfrank.com

Washington D.C.

Brian T. Mangino	+1.202.639.7258	brian.mangino@friedfrank.com