SIMPSON THACHER MEMORANDUM

SEC Issues No-Action Letter Exempting M&A Brokers From Broker-Dealer Registration Requirements in Private M&A Transactions

February 7, 2014

On February 4, 2014, the staff of the Division of Trading and Markets of the Securities and Exchange Commission (the "SEC") issued a No-Action Letter[1] providing that an M&A Broker, as defined below, may engage in certain activities in connection with the purchase or sale of control of a privately-held company without being registered as a broker-dealer. Significantly, the M&A Broker may be involved in negotiations and receive transaction-based compensation.

This memorandum summarizes the relief granted by the SEC in the No-Action Letter, which reduces the regulatory burden imposed on intermediaries in such transactions.

We note that the No-Action Letter does not directly address the issue of transaction-based fees paid to private equity fund advisers by portfolio companies, which issue may be the subject of future guidance from the SEC.

A. BACKGROUND

Prior to the issuance of this No-Action Letter, a person who effected the sale of operating businesses through the sale of securities could be viewed as falling within the meaning of the term "broker" as defined in Section 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act") and, therefore, be required to register as a broker-dealer pursuant to Section 15(b) of that Act. Conversely, if the transaction were structured as an asset sale and did not involve the sale of securities, a person could engage in the same types of activities without registering as a broker-dealer.

B. APPLICABILITY OF RELIEF GRANTED

The relief granted by the SEC applies to M&A Brokers that engage in specified activities in connection with mergers, acquisitions, business sales and business combinations (together, "M&A Transactions") related to privately-held companies.

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[2] through

[1] To view the No-Action Letter, click the following link: http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf

[2] A "privately-held company" for purposes of the No-Action 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. A privately-held company must be an operating company that is a going concern and not a "shell company," as defined below. 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.

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 control and actively operate the company or the business conducted with the assets of the company. The foregoing limitations on the type of buyer in such transactions are discussed in further detail below.

C. RELIEF GRANTED

Subject to the conditions and limitations outlined below, an M&A Broker may engage in the following activities in connection with an M&A Transaction relating to a privately-held company without having to be registered as a broker-dealer:

- facilitate and participate in an M&A Transaction involving the purchase or sale of control of a privately-held company, without regard to the size of the privately-held company;
- advertise a privately-held company for sale with information such as the description of the business, general location, and price range;
- represent either the buyer or the seller of the business, or both of them, so long as the M&A Broker provides clear written disclosure to both parties as to which parties it represents and has obtained written consent from both parties to any joint representation;
- advise the parties to issue securities, or otherwise to effect the transfer of the business by means of securities, or assess the value of any securities sold;
- receive transaction-based or other compensation, as agreed by the parties; and
- participate in negotiations.

D. CONDITIONS AND LIMITATIONS TO RELIEF GRANTED

The relief granted is subject to various conditions and limitations, as set forth below:

- An M&A Broker may not have the ability to bind a party to an M&A Transaction;
- An M&A Broker may 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 connection with the financing in writing to the client;
- An M&A Broker may not 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;

- An M&A Transaction may not involve a public offering. Any offering or sale of securities must be conducted in compliance with an applicable exemption from registration under the Securities Act of 1933 (the "Securities Act");

- Any securities received by the buyer or M&A Broker in an M&A Transaction must 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;

- If an M&A Broker facilitates an M&A Transaction with a group of buyers, the group must be formed without the assistance of the M&A Broker;

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

- The M&A Transaction may not result in the transfer of interests to a passive buyer or group of passive buyers; and

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

The SEC's position is limited to the registration requirements of Section 15(a) of the Exchange Act. Other provisions of the federal securities laws, including the anti-fraud provisions, continue to apply.

So long as the above criteria are satisfied, the No-Action Letter enables M&A Brokers to be actively involved in the purchase and sale of control of privately-held companies without the burden of registering as broker-dealers under the Exchange Act.

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For more information, please contact your relationship partner or one of the following members of Simpson Thacher's Corporate group.

Gary Horowitz
(212) 455-7113
ghorowitz@stblaw.com

Steven R. DeLott
(212) 455-3426
sdelott@stblaw.com

Ashley Belton
(212) 455-3499
ashley.belton@stblaw.com

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017-3954
+1-212-455-2000

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower One
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000