**MERGERS AND ACQUISITIONS: DO I REALLY HAVE TO WORRY ABOUT THE SECURITIES LAWS?**

By Willard A. Blair

Attorneys are often engaged to advise their client regarding the purchase or sale of a business. These transactions are typically structured as a purchase of the assets or stock of the seller or a merger of the seller with the purchaser, or an affiliate thereof. Often a portion of the purchase price may be paid to the seller in stock of the purchaser. While practitioners often focus their efforts on drafting the purchase or merger agreement and the ancillary transaction documents, there are many other issues to consider, such as the securities laws. If not approached carefully, a seemingly straightforward acquisition can land the unsuspecting practitioner, and its client, in hot water with the Securities and Exchange Commission (“SEC”). The focus of this article is to make attorneys who counsel businesses regarding mergers and acquisitions, whether as in-house counsel or otherwise, aware of the securities law implications of these transactions.

**Overview of Securities laws**

The major federal securities laws are the Securities Act of 1933 (the “Securities Act”) and the Securities and Exchange Act of 1934 (the “Exchange Act”). The thrust of the Securities Act is to prohibit misrepresentation or fraud in, and to ensure that investors receive all material information with respect to, the offer and sale of securities to the public by an issuer. The Exchange Act established a system of mandatory disclosures for securities traded on the public markets and sets forth the periodic reporting and disclosure requirements of such issuers, such as quarterly and annual reports, proxy solicitations and tender offers, for example. These laws are administered and enforced by the SEC, whose mission is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”

**Is there a sale of a security?**

It is common knowledge that “stock” is a security; it is defined as such in Section 2 of the Securities Act. What is often overlooked, however, is that a transfer of stock incidental to the sale of a business is also a securities offering to which the Securities Act applies. In 1985, the U.S. Supreme Court held that the securities laws would apply to a sale of a business through the sale of all of the outstanding stock of that business by the stockholders. Of course, the issuance of new stock by one company to the shareholders of another company in exchange for their shares of stock is a securities offering as well.

**If there is a sale of securities, have the securities been registered?**

If securities are being transferred incidental to the sale of a business, they must fall under one of the exemptions from registration or be registered under the Securities Act, which requires that the issuer file a registration statement with the SEC and pay a substantial fee to register the securities. The preparation of a registration statement is a time consuming task.
and the accountants’ and lawyers’ fees incurred in preparing a registration statement can be high. Further, the registration statement’s preparation can take months. Also, the SEC must review and declare the registration statement effective before the stock can be issued. This evaluation period can significantly delay the consummation of the transaction. Moreover, once the securities are registered, the registrant becomes subject to the public reporting and disclosure requirements of the Exchange Act. This, in turn, will require that the company engage qualified attorneys, accountants, and other professionals on an ongoing basis to assist in meeting these requirements.

*Is there an exemption from registration for the securities?*

Due to the time and money involved in registering securities, issuers often try to avoid registration by issuing the securities pursuant to an exemption from registration. Whenever attempting to conduct an unregistered offering of securities, the first two legal issues that must be addressed are (1) which exemption from the registration requirements of the securities laws will be available to the Company, and (2) what type of disclosure will be required. Although there are many statutory exemptions from registration, these exemptions are narrowly tailored and strictly construed. The most common exemption used for stock issued as consideration in a merger or acquisition is the private placement exemption pursuant to section 4(2) of the Securities Act, and the section 4(2) safe harbors contained in Regulation D. Generally, there can be no public solicitation of advertising and the issuer must make (or make available, depending on the specific exemption and the nature of the purchasers) certain disclosure. The securities are also “restricted” and subject to limitations on resale. Moreover, while the issuer can sell to an unlimited number of “accredited investors,” it may only sell securities to a limited number of “non-accredited” purchasers.

*Blue Sky laws*

Whenever unregistered securities are being sold, an exemption from registration must be found not only at the federal level, but also at the state level in each state where a transferee resides. Pursuant to many states’ securities, or “blue sky,” laws, even if an exemption from registration can be found, a notice of the sale may need to be filed with the state. Thus, regardless of which federal exemption applies, a careful analysis of the residency of each potential offeree and of these states’ securities laws should be conducted before the transaction is consummated. Also, where securities will be transferred to non-U.S. citizens or entities, counsel outside the United States should be retained to determine if there is an appropriate exemption from registration in each country of residence.

*Disclosure*

Regardless of whether an exemption from registration applies, the exemption from registration does not exempt the offer or sale of securities from the anti-fraud provisions of both the federal securities laws and the securities laws of the various states. Where shareholders are entitled to vote on the transaction that will result in their receipt of another
issuer’s stock, the issuer must provide (or make available, depending of the type of offering that is being made) to each offeree all available information material to an understanding of the company, its business, and the securities being offered, and the company must not make any material misstatements in connection with the offering. This disclosure is typically made by drafting and delivering a combined prospectus/proxy statement to each shareholder entitled to vote on the acquisition.

**Resale of Securities**

Securities issued pursuant to an exemption from registration are “restricted securities.” They may not be publicly resold unless the shareholder complies with Rule 144, and if the issuer is not a reporting company under the Exchange Act, until the shares have been held for at least one year. If the shares have been registered with the SEC, then they are not restricted and may be freely resold, subject to certain limitations on resales by affiliates of the issuer. Regardless of whether the securities are registered, if a recipient of a purchaser’s shares becomes an officer or director of purchaser, as often occurs in a business acquisition, he may be deemed to have insider information regarding the purchaser. Consequently, the recipient may be subject to insider trading laws, strictly limiting his or her ability to resell the securities.

**Penalties for Violations of the Securities Laws**

The penalties for violating the securities laws can be very severe. Liability for these violations is generally based on either selling unregistered securities without having an applicable exemption or engaging in fraud in the sale of the securities. Under Section 11 of the Securities Act, issuers are liable if a registration statement “contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” Section 12 of the Securities Act establishes liability for unregistered securities sales, creates a purchasers’ right of rescission and establishes liability for fraud regarding the offer or sale of a security. Moreover, where unregistered securities are sold and the company fails to comply with an applicable exemption from registration, not only the company, but also its officers and directors may incur severe civil and criminal fines and penalties.

**Conclusion**

The securities laws are very complex, and business acquisitions may have many securities laws implications which must be carefully considered before the transaction is structured, much less negotiated and consummated. Because of the serious penalties for violating the securities laws, whenever there is an offer or sale of a security, whether in an acquisition or otherwise, securities counsel should be consulted to ensure that the issuer is in full compliance with the securities laws. This article is not meant to be an exhaustive summary
of securities laws and should not be taken as such. Rather, it is meant to merely provide an overview of a few of the multitude of securities laws implicated in mergers and acquisitions.


4 See 17 C.F.R. § 230.144

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