New Exemption for M&A Brokers from Federal Broker-Dealer Registration

Alert
02.10.2023

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Signed into law by President Biden on December 29, 2022, new provisions in the Consolidated Appropriations Act, 2023 (H.R. 2617) (Exemption) exempt certain "M&A brokers" from having to register as broker-dealers with the U.S Securities and Exchange Commission (SEC) for transactions involving eligible privately held companies.

Key Definitions

The Exemption defines an "M&A Broker" as a broker and any associated person that is engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an "eligible privately held company" through the purchase, sale, exchange, issuance, repurchase or redemption of, or a business combination involving securities or assets of the eligible privately held company, if the broker reasonably believes that:

- Upon consummation of the transaction, any person acquiring securities or assets, acting alone or in concert (1) will control the eligible privately held company or the business conducted with the assets of the eligible privately held company (for example, by electing executive officers, approving the annual budget, or serving as an executive or other executive manager); and (2) directly or indirectly, will be active in the management of the eligible privately held company or the business conducted with the assets of the eligible privately held company
- Any buyer, before becoming legally bound to consummate the transaction, has received or has reasonable access to various disclosure documents, including, among others, the company's most recent fiscal year-end financial statements, as well as information pertaining to the management, business,

results of operations, and material loss contingencies of the issuer.

- An "eligible privately held company" is defined as a company that has, in the fiscal year ending immediately before the fiscal year in which the services of the M&A broker are initially engaged with respect to the transaction: (i) no class of securities registered or required to be registered under §12 of the Exchange Act and (ii) earnings before interest, taxes, depreciation, and amortization (EBITDA) less than $25 million and/or gross revenues less than $250 million. The Exemption also provides for an inflation adjustment five years after the date of enactment and every five years thereafter.

"Control" is defined to mean the power to, directly or indirectly, direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. There is a presumption of control if, upon completion of a transaction, the buyer or group of buyers has the right to vote, sell, or direct 25% or more of a class of voting securities or, in the case of a partnership or LLC, has contributed or has the right to receive upon dissolution 25% or more of the capital.

Eligibility

For an M&A Broker to have the benefit of the Exemption, the M&A Broker must not be engaged in any of the following disqualifying activities:

- Directly or indirectly receiving, holding, transmitting, or having custody of funds or securities of the parties in connection with the transaction.
- Engaging on behalf of an issuer in a public offering of any class of securities registered (or required to be registered) under §12 of the 1934 Act or for which the issuer files (or is required to file) periodic reports under §15(d) of 1934 Act,
- Engaging in a transaction involving a shell company, other than a "business combination related shell company" formed solely for purposes of the transaction,
- Providing financing to a party to the transaction directly or indirectly through any of its affiliates.
- Assisting any party to obtain financing from an unaffiliated third party without (i) complying with all other applicable laws in connection with such assistance, including, if applicable, Regulation T; and (ii) disclosing any compensation in writing to the party.
- Representing both the buyer and the seller in the same transaction without providing written disclosure as to the parties represented and obtaining written consent from both parties to the joint representation.
- Assisting to form a group of buyers to acquire the eligible privately held company.
- Engaging in a transaction involving the transfer of ownership of an eligible privately held company to a passive buyer or group of passive buyers.

- Binding a party to a transfer of ownership of an eligible privately held company.

Additionally, an M&A broker will be disqualified from taking advantage of the Exemption if the M&A broker (including any officer, director, member, manager, partner or employee associated with the broker) has been barred from association with a broker or dealer by the SEC, any state, or any self-regulatory organization or suspended from association with a broker or dealer.

History: No-Action Letter

Previously, many such M&A brokers had not registered based on an SEC No-Action Letter released on January 31, 2014, stating that the SEC would not recommend enforcement action against an unregistered "M&A broker" whose activities satisfied certain similar conditions. While this No-Action Letter influenced and created the framework for the Exemption, the Exemption has some important differences, including:

- The Exemption is limited to transactions involving smaller business entities under the EBITDA and/or gross revenue limits described above; the No-Action Letter did not have such size limits. The Exemption does not explicitly limit the authority of the SEC to exempt other transactions, so M&A brokers may be able to continue to look to the No-Action Letter for transactions involving larger private issuers; and
- The Exemption only requires an M&A broker to have a "reasonable belief" that the buyer of the eligible privately held company will control and actively be involved in the management; the No-Action Letter requires that to be factually accurate in any event.

Congress did not preempt state law broker registration or other state law requirements. Therefore, although an M&A broker may be exempt from federal registration as a broker-dealer under the Exemption, that M&A broker may still be required to register with one or more states due to activity in or with residents of that state. Some, but not all, states have similar conditional M&A broker registration exemption or other exempted relief available.

Key Takeaways

- Congress enacted a new Exemption from federal broker-dealer registration for M&A brokers for certain ″control″ transactions involving certain small privately-held companies
- Securities received in the securities transaction will likely be treated as "restricted securities"
- M&A brokers relying on the Exemption will still need to determine whether they are subject to broker-dealer registration under applicable state laws
- The Exemption takes effect on March 29, 2023

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