Congress Passes New M&A Broker Registration Exemption

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On December 29, 2022, President Biden signed into the law the Consolidated Appropriations Act, 2023 (H.R. 2617) (the "Consolidated Appropriations Act"). The Consolidated Appropriations Act included a policy rider in Title V that establishes a federal exemption for certain brokers in mergers and acquisitions ("M&A") transactions for eligible privately held companies from broker-dealer registration by amending Section 15(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").[1] The amendments to Section 15(b) of the Exchange Act will be effective on March 29, 2023.

Background

Section 15(a) of the Exchange Act requires individuals and entities that act as brokers to register with the U.S. Securities and Exchange Commission ("SEC") as a broker, unless qualifying for an exemption. Section 3(a)(4) of the Exchange Act defines a "broker" as any person engaged in the business of effecting transactions in securities for the account of others. Section 15(b) of the Exchange Act describes the process for registering as a broker with the SEC.

In January 2014, the SEC's Division of Trading and Markets issued the M&A Brokers No-Action Letter (the "M&A Broker No-Action Letter")[2] that allowed certain M&A brokers to effect securities transactions in connection with the transfer of ownership of a privately held company without registering as a broker-dealer under Section 15(b) of the Exchange Act, provided that certain conditions were met.[3]

While the M&A Broker No-Action Letter provided some clarity regarding the status of M&A brokers, it has also since raised interpretive issues for brokers. The no-action relief in the M&A Broker No-Action Letter is based on the specific facts and circumstances set forth in the request. This means that other parties may not be able to rely on the M&A Broker No-Action Letter if their facts and circumstances are substantially different to those described in the letter. Further, no-action letters issued by the SEC are not binding precedent on the SEC in any future SEC actions with respect to the same issues. The SEC staff also reserves the right to change its position.

Thus, the amendments provide greater clarity and predictability for M&A brokers in private M&A transactions who are seeking relief from broker-dealer registration under Section 15(b) of the Exchange Act.

Key Definitions of M&A Broker Registration Exemption

The amendments include several key definitions for determining the applicability of the M&A broker exemption from broker-dealer registration under Section 15(b) of the Exchange Act.

M&A Broker. "M&A broker" is defined as a broker, and any person associated with a broker,

engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an eligible privately held company, regardless of whether the broker acts on behalf of a seller or buyer, through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the eligible privately held company. The M&A broker must also reasonably believe that, upon consummation of the transaction, any person acquiring securities or assets of the eligible privately held company will (a) control the company; *and* (b) directly or indirectly, be active in the management of the company. The amendments list the following examples, without limitation, of the kinds of management activities that are deemed "active management" in the company: (1) electing executive officers; (2) approving the annual budget; (3) serving as an executive or other executive manager; or (4) carrying out such other activities as the SEC, by rule, may determine to be in the public interest.

In addition, the amendments provide that if any person is offered securities in exchange for securities or assets of the eligible privately held company, such person must, prior to becoming legally bound to consummate the transaction, receive (or have reasonable access to):

- the most recent fiscal year-end financial statements of the issuer as customarily prepared by its management in the normal course of operations (and if the financial statements are audited, reviewed, or compiled, any related statement by the independent accountant);
- a balance sheet dated not more than 120 days before the date of the offer; and
- information pertaining to the management, business, results of operations for the period covered by the foregoing financial statements, and material loss contingencies of the issuer.

Eligible Privately Held Company. In order for the M&A broker exemption to apply, the transaction must involve an "eligible privately held company." An "eligible privately held company" is a privately held 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 does not file (or is not required to file) periodic reports under Section 15(d) of the Exchange Act. The amendments do, however, impose a size limitation on an eligible privately held company. To be eligible, a privately held company must meet either or both of the following conditions in the fiscal year immediately before the fiscal year in which the M&A broker is initially engaged with respect to the securities transaction: (1) EBITDA of less than $25 million or (2) gross revenues of less than $250 million. These dollar amounts are required to be adjusted for inflation every five years.

Control. The term "control" is defined as the power, directly or indirectly, to 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 consummation of the transaction, the buyer or group of buyers has (a) the right to vote, sell, or direct the sale of 25% or more of a class of voting securities of the company or (b) 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.

Excluded Activities

The amendments provide that an M&A broker is not exempt from broker-dealer registration if the broker engages in any of the following excluded activities:

- Directly or indirectly, receives, holds, transmits, or has custody of funds or securities to be exchanged by the parties to the transaction.
- Engages on behalf of an issuer in a public offering of any class of securities registered (or required to be registered) under Section 12 of the Exchange Act or for which the issuer files (or is required to file) periodic reports under Section 15(d) of Exchange Act.
- Engages in a transaction involving a "shell company" (as defined in the amendments), other than a "business combination related shell company".[4]

- Directly, or indirectly through any of its affiliates, provides financing related to the transfer of ownership of an eligible privately held company.
- Assists in obtaining financing from an unaffiliated third party without complying with all other applicable laws and disclosing any compensation in writing to the assisted party.
- Represents both buyer and seller in the same transaction without providing clear written disclosures to the parties and obtaining written consent from both parties to the joint representation.
- Facilitates a transaction with a group of buyers formed with the assistance of the M&A broker to acquire the eligible privately held company.
- Engages in a transaction involving the transfer of ownership of an eligible privately held company to a passive buyer or group of passive buyers.
- Binds a party to a transfer of ownership of an eligible privately held company.

Disqualification

The amendments also provide that an M&A broker may be disqualified from the exemption to broker-dealer registration if the broker (including any officer, director, member, manager, partner or employee of such broker) has been (a) barred from association with a broker or dealer by the SEC, any state, or any self-regulatory organization or (b) suspended from association with a broker or dealer.

Key Takeaways of M&A Broker Registration Exemption

- Certain M&A brokers engaged in securities transactions in connection with the transfer of ownership of an eligible privately held company are now allowed to receive transaction-related compensation without registering as a broker under Section 15(b) of the Exchange Act.
- The amendments included in Title V of the Consolidated Appropriations Act are essentially a codification of the SEC's M&A Broker No-Action Letter, with a few key differences. Notably, the amendments include a limitation on the size of an eligible privately held company, whereas the M&A Broker No-Action Letter has no cap on the size of the company. However, unless the SEC withdraws the M&A Broker No-Action Letter, an M&A broker involved in a private M&A transaction with a larger company could still rely on the no-action letter if the broker meet the conditions for that relief.
- While the amendments provide a federal exemption from broker-dealer registration with the SEC, they do not provide an exemption for broker-dealer registration under state securities laws. Accordingly, M&A brokers, whether or not they are exempt from federal broker-dealer registration, must still comply with any applicable state securities laws requiring registration of brokers. Many states are considering or have implemented a similar exemption from state broker registration laws.

For more information on the M&A broker registration exemption, please contact Ryan A. Whelpley.

[1] Consolidated Appropriations Act, 2023, H.R. 2617, 117th Cong., Div. AA, Title V, § 501 (2022) (enacted).

[2] M&A Brokers No-Action Letter (January 31, 2014, amended February 4, 2014).

[3] *Id.*

[4] H.R. 2617 § 501(E)(i) defines a "business combination related shell company" as a shell company formed by a non-shell company solely for the purpose of changing the corporate domicile of that entity or completing a business combination transaction among one or more entities other than the company itself, none of which is a shell company.