Registration Exemption for Merger and Acquisition Brokers

Posted in Alert on January 27, 2023

BACKGROUND

Section 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act") requires registration with the Securities and Exchange Commission (the "SEC") of securities brokers, which is defined as "any person engaged in the business of effecting transactions in securities for the account of others.

It has long been the position of the SEC that, in almost all cases, business brokers and finders should register as brokers and become members of the Financial Industry Regulatory Authority ("FINRA"). The SEC has determined that a person who brokers the sale of a business or facilitates the placement of securities for compensation is a broker within the meaning of the Exchange Act. Notwithstanding the SEC's position, many business brokers and finders have chosen to "fly beneath the radar" to avoid the expense and regulatory oversight of registration with the SEC.

In order to provide a limited exemption from registration the SEC issued a no-action letter dated January 31, 2014 (the "No-Action Letter") setting forth guidelines which business brokers could follow to be exempt from federal broker-dealer registration. Shortly thereafter in 2015, the North American Securities Administration Association ("NASAA") adopted a model rule (the "Model Rule"), which largely followed the requirements of the No-Action Letter, which, if adopted by a state, provided a state level exemption from registration. As many as twenty states have adopted the NASAA model rule.

FEDERAL M&A BROKER EXEMPTION

As part of the Consolidated Appropriations Act enacted on December 29, 2022, a new subsection 15(b)(13) to the Exchange Act was added which provides a statutory exemption (the "Exemption") from SEC registration for "M&A brokers." The Exemption takes effect on March 29, 2023. Key defined terms contained in the Exemption are:

M&A Broker is a broker engaged in the business of effecting securities transactions solely related to the transfer of ownership of an "eligible privately held company" ("EPHC") whether acting on behalf of the buyer or seller through the sale, exchange or other disposition of the securities or assets of the EPHC, provided that:

> (a) the broker must reasonably believe that upon consummation of the transaction any person acquiring securities or assets of the EPHC (i) will control the EPHC and (ii) directly or indirectly be active in the management of the EPHC, and
>
> (b) if any person is offered securities in exchange for securities or assets of the EPHC, such person will receive, or have reasonable access to, the most recent fiscal year-end financial statements of the issuer of the securities as customarily prepared by the management of the issuer in the normal course of operations and, if the financial statements of the issuer 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.

EPHC is defined as a company which (a) does not have any class of securities registered, or required to be registered under Section 12 of the Exchange Act or does not, or is not required to file, periodic reports under Section 15(d) of the Exchange Act and (b) for the fiscal year immediately preceding the fiscal year in which the M&A broker engages in the M&A transaction, the EPHC has either or both of the following (i) EBITDA of less than $25 million and (ii) gross revenues of less than $250 million (both dollar amounts adjusted for inflation every five years).

Control means the power, directly or indirectly, to direct the management or policies of the EPHC whether by ownership of securities, by contract, or otherwise. There is a presumption of control where the buyer has the right to vote 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 in dissolution, or has contributed 25% or more of the capital.

Excluded Activities. An M&A broker engaging in any of the following activities will not be eligible for the Exemption:

"(i) Directly or indirectly, in connection with the transfer of ownership of an EPHC, receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties to the transaction.

"(ii) Engages on behalf of an issuer in a public offering of any class of securities that is registered, or is required to be registered, with the SEC under Section 12 of the Exchange Act or with respect to which the issuer files, or is required to file, periodic information, documents, and reports under Subsection 15(d) of the Exchange Act.

"(iii) Engages on behalf of any party in a transaction involving a shell company, other than a business combination related shell company.

"(iv) Directly, or indirectly through any of its affiliates, provides financing related to the transfer of ownership of an EPHC.

"(v) Assists 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 (12 C.F.R. 220 et seq.); and

"(II) disclosing any compensation in writing to the party.

"(vi) Represents both the buyer and the seller in the same transaction without providing clear written disclosure as to the parties the M&A broker represents and obtaining written consent from both parties to the joint representation.

"(vii) Facilitates a transaction with a group of buyers formed with the assistance of the M&A broker to acquire the EPHC.

"(viii) Engages in a transaction involving the transfer of ownership of an EPHC to a passive buyer or group of passive buyers.

"(ix) Binds a party to a transfer of ownership of an EPHC."

Disqualification. An M&A broker may not utilize the Exemption if the M&A broker (or any officer, director, member, manager, partner or employee of the broker) (a) has been barred from association with a broker or dealer by the SEC, any state, or any self-regulatory organization; or (b) is suspended from association with a broker or dealer.

It is important to note that the Exemption does not result in the withdrawal of the No-Action Letter which will remain in effect unless and until the SEC takes formal action in this regard. Consequently, M&A brokers may also follow the guidelines of the No-Action letter, which notably, does not have the size of company limitation of the Exemption.

Additionally, it should be noted the Exemption does not preempt applicable state laws and regulations regarding broker dealer registration, which may or may not follow NASAA's Model Rule.

We Can Help

For questions, please contact Scott McGinness or another member of our Securities Practice Group.