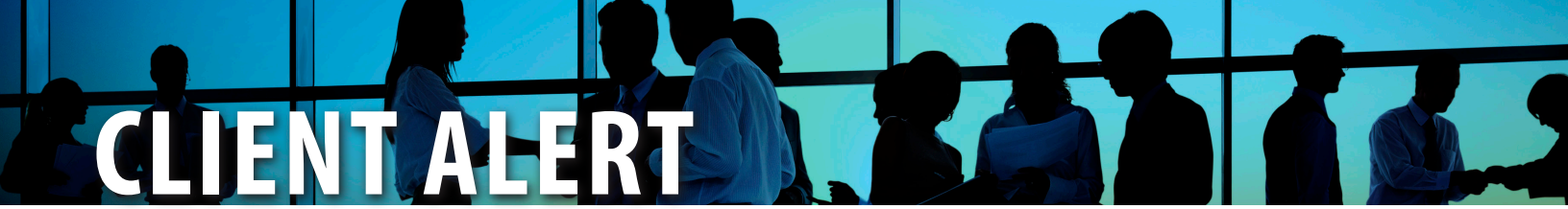


CONGRESS PROVIDES M&A BROKERS A STATUTORY EXEMPTION FROM EXCHANGE ACT REGISTRATION

by Bradley J. Wyatt and Randolph F. Pistor II

On December 29, 2022, President Biden signed the Consolidated Appropriations Act, 2023 (H.R. 2617) (the "CAA") into law (PL 117-328).[1] Buried within Title V of Division AA is Section 501, entitled "Registration Exemption for Merger and Acquisition Brokers."[2] As this Client Alert explains, this new statutory provision could ultimately reshape the federal registration exemption available to merger and acquisition brokers by limiting the size of the privately-held companies they assist. The CAA does not preempt any state blue sky registration requirements for M&A brokers.

Background

Section 3(a)(4)(A) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others."[3] Persons who qualify as brokers must register with the U.S. Securities and Exchange Commission (the "SEC") under Section 15(a) of the Exchange Act. In contrast, Section 15(b) sets forth the manner of such registration. Registration requirements may also apply under state blue sky laws and FINRA rules.

Ordinarily, a person engaged in effecting securities transactions in connection with the transfer of ownership and control of privately-held companies might be deemed a "broker" under the Exchange Act, particularly if such business involves the receipt of commissions or transaction-based compensation. However, in an important no-action letter from 2014 (the "M&A No-Action Letter"),[4] the staff at the SEC's Division of Trading and Markets concluded that such an "M&A broker" need not register with the SEC under Section 15(b) of the Exchange Act as long as certain conditions are satisfied.

Since the M&A No-Action Letter was issued, it has become the definitive source of regulatory guidance for M&A brokers who wish to avoid SEC registration. Soon after the M&A No-Action Letter was issued, the North American Securities Administrators Association ("NASAA") issued its own Model Rule providing a framework for states to enact their own M&A broker registration exemptions.

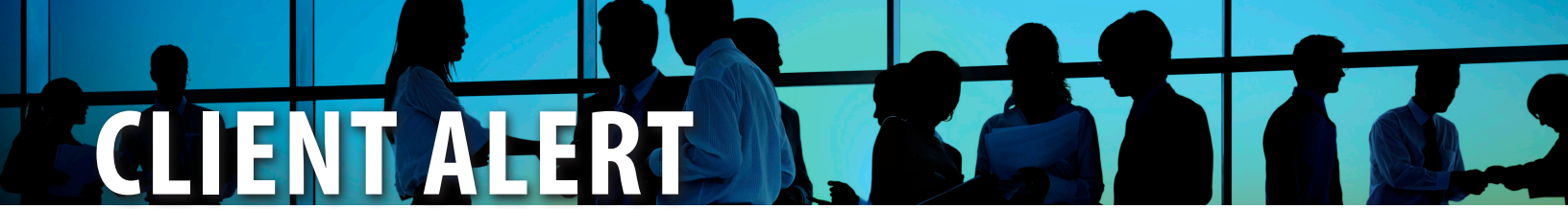
The contours of the new M&A broker registration exemption included in the CAA are similar to those found in the M&A No-Action Letter. However, the new statutory exemption, which is codified as new Section 15(b)(13) of the Exchange Act, incorporates several concepts from the Model Rule as well. Under Section 501(b) of Title V of Division AA, the new statutory exemption takes effect on March 29, 2023.

Comparison of the M&A No-Action Letter and the CAA's Statutory Exemption

The following table summarizes the key similarities and differences between the M&A No-Action Letter and the new statutory exemption included in the CAA.

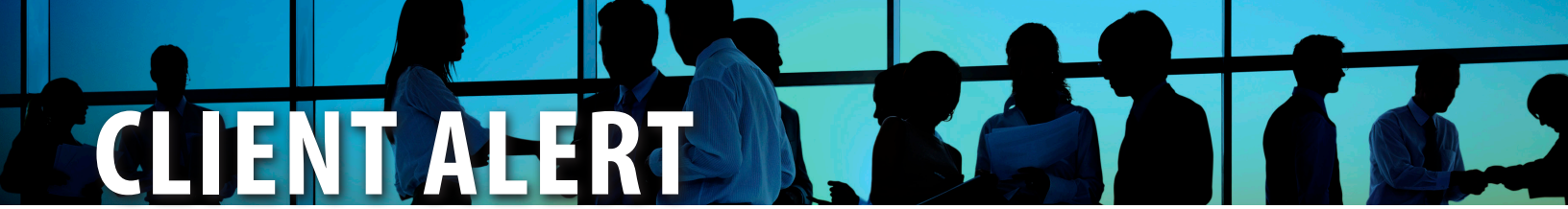
	M&A No-Action Letter	Statutory Exemption (citations are to the Exchange Act)
Definition of "M&A broker"	A person engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company … through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the company, to a buyer that will actively operate the company or the business conducted with the assets of the company.	***Similar but with very important differences*** [Section 15(b)(13)(E)(iv)]

[1] A copy of the CAA is available at: https://www.congress.gov/117/bills/hr2617/BILLS-117hr2617enr.pdf.
[2] Section 501 is found on pages 1080–1084 of the CAA.
[3] 15 U.S.C. § 78c(a)(4)(A).
[4] M&A Brokers, SEC No-Action Letter, 2014 WL 356983 (Jan. 31, 2014). A slightly revised draft of the M&A No-Action Letter was published on February 4, 2014 and is available at: https://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf.
[5] *See* Model Rule Exempting Certain Merger & Acquisition Brokers ("M&A Brokers") From Registration (Sept. 29, 2015), available at: https://www.nasaa.org/wp-content/uploads/2011/07/MA-Broker-Model-Rule-adopted-Sept-29-2015-corrected.pdf. The Model Rule does not incorporate many of the restrictions on M&A brokers' activities found in the M&A No-Action Letter or new Section 15(b)(13) of the Exchange Act.



Definition of "control"	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.[6]	Same [Section 15(b)(13)(E)(ii)]
Definition of "privately-held company"	An operating company that is a going concern and 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.	***Only partially similar and with very important differences*** [Sections 15(b)(13)(E)(iii) & 15(b)(13)(F)]
Buyer's Post-Transaction Conduct	The buyer must actively operate the privately-held company or the business conducted with the company's assets in the M&A transaction. 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.	Similar [Section 15(b)(13)(E)(iv)(I)]
Exemption Condition #1	The M&A broker will not be able to bind a party to an M&A transaction.	Same [Section 15(b)(13)(B)(ix)]
Exemption Condition #2	The M&A broker will not, directly or indirectly through any of its affiliates, provide financing for the M&A transaction. If the M&A broker assists purchasers in obtaining financing from unaffiliated third parties, it must comply with all applicable legal requirements, including, as applicable, Regulation T, and must disclose any compensation in writing to the client.	Same [Section 15(b)(13)(B)(iv)–(v)]
Exemption Condition #3	The M&A broker will not have custody, control, or possession of or otherwise handle funds or securities issued or exchanged in connection with the M&A transaction.	Very similar [Section 15(b)(13)(B)(i)]

[6]Importantly, the NASAA's Model Rule uses a lower 20% threshold for control.



Exemption Condition #4	No party to the M&A transaction will be a shell company[7] other than a business combination-related shell company,[8] and any offering or sale of securities will be nonpublic and conducted in compliance with an applicable exemption from registration under the Securities Act of 1933, as amended (the "Securities Act").	Same [Section 15(b)(13)(B)(ii)–(iii)]
Exemption Condition #5	To the extent the M&A broker represents both buyers and sellers, it will provide clear written disclosure as to the parties it represents and obtain written consent from both parties to the joint representation.	Same [Section 15(b)(13)(B)(vi)]
Exemption Condition #6	The M&A broker will facilitate the M&A transaction with a group of buyers only if the group is formed without the assistance of the M&A broker.	Same [Section 15(b)(13)(B)(vii)]
Exemption Condition #7	The buyer, or group of buyers, in any M&A transaction, will, upon completion of the M&A transaction, control and actively operate the company or the business conducted with the business's assets.	Similar; the M&A broker must reasonably believe this is the case [Section 15(b)(13)(E)(iv)(I)]
Exemption Condition #8	No M&A transaction will result in the transfer of interests to a passive buyer or group of passive buyers.	Same [Section 15(b)(13)(B)(viii)]
Exemption Condition #9	Any securities received by the buyer or M&A broker in the M&A transaction will be restricted securities within the meaning of Rule 144(a)(3) under the Securities Act.	Not mentioned [but implied as a result of the public offering prohibition in Section 15(b)(13)(B)(ii)]
Exemption Condition #10	The M&A broker (and, if the M&A broker is an entity, each officer, director, or employee of the M&A broker): (i) has not been barred from association with a broker-dealer by the SEC, any state, or any self-regulatory organization; and (ii) is not suspended from association with a broker-dealer.	Same [Section 15(b)(13)(C)]

[7]The term "shell company" means "a company that: (1) has no or nominal operations; and (2) has: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets." M&A Brokers, 2014 WL 356983 at *1 n.1. The definition under Section 15(b)(13)(E)(v) of the Exchange Act is nearly identical.

[8]The term "business combination related shell company" means "a shell company (as defined in Securities Act Rule 405) that is: (1) formed by an entity that is not a shell company solely for the purpose of changing the corporate domicile of that entity solely within the United States; or (2) formed by an entity defined in Securities Act Rule 165(f) among one or more entities other than the shell company, none of which is a shell company." *Id.* at *2 n.2. The definition under Section 15(b)(13)(E)(i) of the Exchange Act is nearly identical.

Key Takeaways

As the table demonstrates, the differences between the M&A No-Action Letter and the statutory exemption are definitional. First, the CAA defines "eligible privately held company" to ***exclude*** certain larger privately-held companies. Specifically, for the statutory exemption to be available, 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 M&A transaction, the privately-held company must either have EBITDA of less than $25 million or gross revenues of less than $250 million.[9] This limitation is a mirror image of the NASAA's Model Rule. Congress authorized the SEC to later adjust these dollar thresholds for inflation every five years.

Additionally, the CAA defines "M&A broker" in such a way as to alter the definition provided in the M&A No-Action Letter. First, for the buyer's post-transaction requirement to be active in the management of the privately-held company or the business conducted with the assets of the privately-held company,[10] the statutory exemption clarifies that the M&A broker must *reasonably believe* this post-transaction requirement will be satisfied.[11]

Second, the statutory exemption imposes a due diligence requirement in certain circumstances, which is another provision borrowed from the NASAA's Model Rule. Specifically, the M&A broker must reasonably believe[12] that

> if any person is offered securities in exchange for securities or assets of the eligible privately held company, such person will, before becoming legally bound to consummate the transaction, 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 about the management, business, results of operations for the period covered by the preceding financial statements, and material loss contingencies of the issuer.[13]

Therefore, if an M&A broker intends to rely upon the statutory exemption, this minimum level of financial disclosure will be required in connection with the M&A transaction.

At this time, it remains unclear if the SEC staff will withdraw the M&A No-Action Letter. This is important to monitor, as the M&A No-Action Letter does not limit the size of the privately-held company involved in the M&A transaction. Notably, the new statutory exemption explicitly provides that it does not limit the authority of the SEC to exempt any person from any provision of the Exchange Act.[14] Thus, until the M&A No-Action Letter is withdrawn, M&A brokers should still be able to rely on the M&A No-Action Letter if they wish to engage in M&A transactions involving privately-held companies with EBITDA exceeding $25 million and gross revenues exceeding $250 million.

In addition, it is unknown if the NASAA's Model Rule will be modified to align with the new statutory exemption, or if states will enact new laws or promulgate new regulations to exempt M&A brokers from state registration requirements. At present, 22 states have some form of a registration exemption for M&A brokers, whether through statute, regulation, administrative order, policy, no-action letter, or interpretive opinion,[15] but these could also change in light of the new statutory exemption. Consequently, even when relying on the new statutory exemption – or the M&A No-Action Letter – to avoid federal registration, M&A brokers should also confirm that state registration is not required due to conducting M&A broker activity that is subject to the requirements of one or more states or jurisdictions.

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[9] *See* Exchange Act § 15(b)(13)(E)(iii)(II).
[10] *See* Exchange Act § 15(b)(13)(E)(iv). The Model Rule also requires the M&A broker to reasonably believe this post-transaction requirement will be satisfied.
[11] *See* Exchange Act § 15(b)(13)(E)(iv)(I)(bb).
[12] The NASAA's Model Rule does not include a reasonable belief requirement for this due diligence component.
[13] *See* Exchange Act § 15(b)(13)(E)(iv)(II).
[14] *See* Exchange Act § 15(b)(13)(D).
[15] These jurisdictions include Alaska, Arkansas, California, Colorado, Florida, Georgia, Illinois, Iowa, Maryland, Michigan, Mississippi, Montana, Nebraska, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, and Vermont.