PROGRESS FOR M&A BROKERS: CONGRESS PASSES NEW EXEMPTION FROM SECURITIES BROKER REGISTRATION

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As noted in our prior blog post, on 29 December 2022, President Biden signed into law the Consolidated Appropriations Act of 2023 (H.R. 2617). Among the routine federal funding provisions, the bill included a holiday surprise "policy rider" for qualifying mergers and acquisitions brokers (M&A brokers) in Division AA, Title V, Small Business Mergers, Acquisitions, Sales and Brokerage Simplification.

Currently, M&A brokers must rely on a no-action letter published by the U.S. Securities and Exchange Commission (SEC) (as discussed below) in order to engage in the business of effecting M&A securities transactions of privately-held companies without registering as a broker with the SEC. Under the policy rider (the M&A Broker Exemption), M&A brokers will have the benefit of a federal exemption from SEC registration.

REGISTRATION EXEMPTION FOR M&A BROKERS

Section 15(a) of the Securities Exchange Act of 1934 (Exchange Act) requires securities brokers to register with the SEC and Section 15(b) prescribes the manner of registration. 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." The M&A Broker Exemption provides an exemption from registration for small business M&A brokers by amending Section 15(b) to add new subsection (13) "Registration Exemption for Merger and Acquisition Brokers." The M&A Broker Exemption will be effective 90 days after enactment, on 29 March 2023.

The M&A Broker Exemption defines an "M&A broker" as 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, if the broker reasonably believes that:

> (i) upon consummation of the transaction, any person acquiring securities or assets of the eligible privately held company, acting alone or in concert (aa) will control the eligible privately held company or the business conducted with the assets of the eligible privately held company; and (bb) 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, including without limitation, for example, by electing executive officers; approving the annual budget; or serving as an executive or other executive manager;

> and

> (ii) in the event that any person is offered securities of an issuer in exchange for securities or assets of the eligible privately held company, before the transaction is consummated, the person will receive or have reasonable access to the issuer's most recent fiscal year-end financial statements, any related statements from the independent accountant if the financials are audited, a balance sheet dated no more than 120 days before the offer date, and information about the business, its management, and any material loss contingencies.

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 Exchange Act Section 12 and (ii) EBITDA less than US$25 million and/or gross revenues less than US$250 million. The M&A Broker 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.

EXCLUDED ACTIVITIES AND DISQUALIFICATION

The M&A Broker Exemption includes a list of activities that would fall outside of the exemption and would continue to require registration as a broker. Such activities include if the broker maintains custody of or transmits funds or securities to be exchanged by parties to the transaction, engages in a public offering or transaction involving a shell company (other than a business combination shell company, as defined in the M&A Broker Exemption), provides financing, represents both buyer and seller without obtaining consent or forms a group of buyers, engages in a transaction involving a passive buyer(s), or binds a party to a transaction. Furthermore, an M&A broker cannot assist any party to the transaction in obtaining financing from an unaffiliated third party without complying with Regulation T or other applicable law and disclosing any compensation in writing to the party. Lastly, any person who has been barred or suspended from associating with a broker-dealer under federal or state law or by a self-regulatory organization may not rely on the exemption.

KEY TAKEAWAYS

The treatment of M&A brokers has a long and tortured history. M&A brokers legislation has been proposed by several Congresses in different forms. Although none of those bills were able to get enough traction to pass both

houses of Congress on a standalone basis, proponents were able to have the provisions of S. 3391/H.R. 935 (the most recent version of the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act introduced to Congress) included in the annual must-pass federal funding measure (H.R. 2617). On 23 December 2022, the House of Representatives passed H.R. 2617, following Senate passage on 22 December.

The new M&A Broker Exemption is essentially the codification of the SEC M&A Brokers No-Action Letter dated 31 January 2014, amended 4 February 2014 (M&A Broker NAL) with some differences, notably, a limitation on the size of eligible privately held companies. The size limitation imposed by the M&A Broker Exemption is consistent with the North American Securities Administrators Association (NASAA) Model Rule, adopted 29 September 2015 (the Model Rule). However, the M&A Broker Exemption differs from the Model Rule in several respects, including that the control threshold in the Model Rule is 20% compared to 25% in the M&A Broker Exemption. Moreover, while the M&A Broker Exemption provides a federal exemption from registration for M&A brokers, they still must consider the state broker registration laws. Approximately 20 states have or are considering a conditional M&A broker registration exemption or other exemptive relief.

The most recent version of the bill introduced to Congress (S. 3391/H.R. 935) received crucial support from state regulators. On 1 December 2022, NASAA sent a letter to U.S. Senate and House committee leaders expressing concern about certain proposed capital raising proposals that could undermine state authority but supporting S. 3391/H.R. 935. It is possible that NASAA may now seek to align the Model Rule with the M&A Broker Exemption.

In addition, it is unclear whether (or when) the SEC will withdraw the M&A Broker NAL. There are some key differences between the M&A Broker Exemption and the M&A Broker NAL, most notably, as referenced above, the M&A Broker NAL does not include a limitation on the size of an eligible privately held company. It is conceivable that absent withdrawal of the M&A Broker NAL, an M&A broker could still rely on the M&A Broker NAL for a transaction involving a larger company.

In 2020, the SEC proposed an exemption for finders that would have provided a limited, conditional exemption from broker registration requirements for persons who assist issuers to raise capital from accredited investors in private offerings. The proposed finders exemption faced considerable opposition from NASAA, the Financial Industry Regulatory Authority, and industry groups. However, the M&A Broker Exemption does not permit capital raising and has no bearing on the finders exemption, which is not expected to be adopted in its proposed form.

M&A brokers currently relying on the M&A Broker NAL now may be eligible to rely on a federal exemption. Those who do not fall within its parameters will want to pay close attention to whether the SEC withdraws the M&A Broker NAL. All M&A brokers should stay tuned for SEC and state regulatory developments.

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