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Locke Lord QuickStudy: New Federal Statutory M&A Broker ?Exemption to Take Effect March 29th

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On March 29, 2023, a new federal statutory exemption for M&A brokers takes effect by the addition of Section 15(b)(13) to the Securities Exchange Act of 1934 (the “Exchange Act”). The new provision exempts certain M&A brokers involved in covered transactions from the broker registration requirement of Section 15(b) of the Exchange Act that otherwise requires all persons acting as brokers in connection with the sale or exchange of securities to be registered under the Exchange Act (Division AA, Title V – Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification).

Since 2014, M&A brokers have been relying on a 2014 Securities and Exchange Commission no action letter (published January 31, 2014, as amended February 4, 2014) (the “No Action Letter”) as a basis for acting in non-public M&A transactions as brokers and facilitators without registering as a broker under Section 15(b). The new law adds a statutory basis for the exemption but with a number of conditions that have not been understood to be applicable under the No Action Letter. These include, among other conditions, a size of the target test for eligible privately held businesses (not more than $25 million in EBITDA and not more than $250 million in gross revenues in the prior year) as well as a list of disqualifying considerations and so-called “bad boy” exemptions.

Under the new section 15(b)(13) to be included in the Exchange Act, a M&A broker who is entitled to claim the exemption must be a “person 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” provided that 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–

“(AA) electing executive officers;

“(BB) approving the annual budget;

“(CC) serving as an executive or other executive manager; or

“(DD) carrying out such other activities as the Commission may, by rule, determine to be in the public interest; and

“(II) if any person is offered securities in exchange for securities or assets of the eligible privately held company, such person will, 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 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.”

This new exemption permits a M&A broker to act for both seller and buyer, or either of them, without the loss of the exemption as long as for joint representations all of the parties sign an adequately written disclosure document and consent.

An important limitation of the new exemption is the prohibition against “directly, or indirectly through any of its affiliates, [providing] financing related to the transfer of ownership of an eligible privately held company or [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 (12 C.F.R. 220 et seq.); and

(ii) disclosing any compensation in writing to the party.

This new federal statutory exemption provides increased certainty for M&A brokers who can meet its requirements but it can be more limiting than reliance on the No Action Letter. There is no assurance that the No Action Letter and the statutory exemption (when it becomes effective) will stand side by side as available alternatives for exemption from the federal broker registration requirement. It is possible that the SEC will provide further guidance regarding the viability of the No Action Letter or revise its requirements and M&A brokers and their counsel should stay alert to this possibility. In addition, it is important to remember that there are also state broker registration requirements that remain unaffected. Some states have adopted exemptions similar, although with some differences, to the new federal exemption but that is not true for all states. Therefore, M&A brokers and their counsel should be mindful of both the federal and state broker registration requirements and the need to comply with the particular exemptions that are applicable, one of which beginning March 29 will be the new exemption under Section 15(b)(13).

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