

Legal Update

A New Federal Exemption from Broker Registration for Qualifying M&A Brokers Became Effective on March 29, 2023 (Prior SEC No-Action Relief Has Been Withdrawn)

Although the New Federal Exemption Is Generally Aligned with the SEC's 2014 No-Action Relief, There Are Some Notable Differences. Moreover, State Law Registration Requirements for M&A Brokers Are Not Preempted.

The U.S. Congress recently enacted a conditional exemption (the "Exemption") from registration under Section 15(b) of the Securities Exchange Act of 1934 (the "Exchange Act") for qualifying brokers that facilitate merger and acquisition ("M&A") transactions involving certain privately held companies.¹ The Exemption essentially is a codification of relief for certain M&A brokers from the Exchange Act's broker registration requirements that the staff of the Division of Trading and Markets of the U.S. Securities and Exchange Commission ("SEC") previously granted in a 2014 no-action letter ("2014 NAL").² However, the Exemption is narrower in that it imposes limitations on the size of the privately held company that is the subject of an M&A transaction. The Exemption became effective on March 29, 2023; that same day, the SEC staff withdrew the 2014 NAL effective immediately.

The following provides an overview of the Exemption and certain practical considerations, including considerations under state securities laws.

Background

Section 15(a)(1) of the Exchange Act generally requires "brokers"³ to register with the SEC pursuant to Section 15(b) of the Exchange Act, unless an exception or exemption is available. The 2014 NAL permitted qualifying M&A brokers to effect securities transactions in connection with the transfer of ownership of a privately held company without having to register under the Exchange Act, so long as certain conditions were met. Notably, the 2014 NAL did not impose any limitations on the size of the privately held company that was the subject of the M&A transaction.⁴

In addition to the federal securities laws, each U.S. state and territory, and the District of Columbia, has its own broker-dealer registration requirements. As such, as has previously been the case, M&A brokers relying on the Exemption must also assess whether they can rely on an exclusion or exemption from broker-dealer registration under the relevant state securities or “Blue Sky” laws. While a number of states provide an exemption from registration for certain M&A brokers, some of which are based on a model rule (the “Model Rule”) adopted by the North American Securities Administrators Association (“NASAA”) in 2015, the Model Rule has not been adopted universally or consistently, and certain Blue Sky laws do not provide any express exemption for M&A brokers.⁵

Overview of the Exemption

DEFINITIONS

M&A Broker. The term “M&A broker” for purposes of the Exemption means 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” (defined below) 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 M&A broker *reasonably believes* that:

1. Upon consummation of the transaction, any person acquiring securities or assets of the eligible privately held company, acting alone or in concert will both:
 - a. Control the eligible privately held company or the business conducted with the assets of the eligible privately held company; and
 - b. Directly or indirectly, 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; serving as an executive or other executive manager; or carrying out such other activities as the SEC may, by rule, determine to be in the public interest; and
2. 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.

Eligible Privately Held Company. The term “eligible privately held company” means a privately held company that: (i) has no class of securities registered (or required to be registered) under Section 12 of the Exchange Act or with respect to which the company files (or is required to file) periodic information, documents and reports under Section 15(d) of the Exchange Act; and (ii) 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, the company meets either or both of the following conditions (determined in accordance with the historical financial accounting records of the company): (a) earnings before interest, taxes, depreciation and amortization (“EBITDA”) less than \$25 million; or (b) gross revenues less than \$250

million (together, the "EBITDA/Gross Revenue Limitation"). The Exemption provides for an inflation adjustment of the dollar amounts of the EBITDA/Gross Revenue Limitation five years after the date of enactment and every five years thereafter.

Control. The term "control" means 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 completion of a transaction, the buyer or group of buyers has the right to vote, 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 contributed or has the right to receive upon dissolution 25% or more of the capital.

Shell Company. The term "shell company" includes any company that, at the time of a transaction with an eligible privately held company, has: (i) no or nominal operations; and (ii) either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets.

Business Combination Related Shell Company. The term "business combination related shell company" means a shell company that is formed by an entity that is not a shell company: (i) solely for the purpose of changing the corporate domicile of that entity solely within the U.S.; or (ii) solely for the purpose of completing a business combination transaction (as defined under 17 C.F.R. § 230.165(f)) among one or more entities other than the company itself, none of which is a shell company.

EXCLUDED ACTIVITIES

The following activities are excluded from the scope the Exemption, and, therefore, an M&A broker who engages in any such activities cannot rely on the Exemption.

1. Directly or indirectly receiving, holding, transmitting, or having custody of the funds or securities to be exchanged by the parties in connection with a transaction for the transfer of ownership of an eligible privately held company.
2. Engaging 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 with respect to which the issuer files (or is required to file) periodic information, documents and reports under Section 15(d) of the Exchange Act.
3. Engaging on behalf of any party in a transaction involving a shell company, other than a business combination related shell company.
4. Directly, or indirectly through any of its affiliates, providing financing related to the transfer of ownership of an eligible privately held company.
5. 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, and (ii) disclosing any compensation in writing to the party.
6. Representing 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.

7. Facilitating a transaction with a group of buyers formed with the assistance of the M&A broker to acquire the eligible privately held company.
8. Engaging in a transaction involving the transfer of ownership of an eligible privately held company to a passive buyer or group of passive buyers.
9. Binding a party to a transfer of ownership of an eligible privately held company.

DISQUALIFICATION

An M&A broker is not eligible to rely on the Exemption if such broker (and if and as applicable, including any officer, director, member, manager, partner or employee of such broker): (i) has been barred from association with any broker-dealer by the SEC, any state or any self-regulatory organization; or (ii) is suspended from association with a broker-dealer.

Practical Considerations

The EBITDA/Gross Revenue Limitation was not included in the 2014 NAL and may present challenges for M&A brokers seeking to rely on the Exemption going forward.

Moreover, M&A brokers remain subject to the broker-dealer registration requirements of the Blue Sky laws. As described above, certain states have an existing registration exemption for M&A brokers based on NASAA's Model Rule, which generally aligns with the conditions and limitations of the Exemption. There are some notable differences, however, such as the "control" threshold (25% in the Exemption, 20% in the Model Rule) and certain additional activities – namely, items 4 through 9 in the "Excluded Activities" section above – that are excluded from the scope of the Exemption but not the Model Rule. M&A brokers should monitor whether NASAA proposes amendments to its Model Rule (which must then be adopted by each state) as well as any actions by individual state legislatures and/or securities authorities to more closely align their respective registration requirements to the Exemption. In the meantime, M&A brokers must continue to assess relevant state-level broker-dealer registration requirements in connection with their M&A activities.

For more information about the topics raised in this Legal Update, please contact any of the following authors.

Steffen Hemmerich

+1 212 506 219

shemmerich@mayerbrown.com

Anna T. Pinedo

+1 212 506 2275

apinedo@mayerbrown.com

Stephen C. Vogt

+1 212 263 3364

svogt@mayerbrown.com



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ENDNOTES

¹ See Consolidated Appropriations Act, 2023 (H.R. 2617), 117th Cong. § 501 (2022) (codified in Section 15(b)(13) of the Exchange Act), available [here](#) (pages 1080-1084).

² See [M&A Brokers](#), SEC No-Action Letter (dated Jan. 31, 2014, revised Feb. 4, 2014, withdrawn Mar. 29, 2023).

³ Section 3(a)(4)(1) of the Exchange Act defines the term “broker” to generally include any person engaged in the business of effecting transactions in securities for the account of others.

⁴ The 2014 NAL defined the term “privately-held company” to mean a 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 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. Additionally, to be eligible under the 2014 NAL, the privately-held company must have been an operating company that was a going concern and not a shell company.

⁵ See [NASAA Model Rule Exempting Certain Merger & Acquisition Brokers From Registration](#) (adopted Sept. 29, 2015). NASAA proposed this model rule following, and in such proposal made specific reference to, the SEC staff’s 2014 NAL. See [Notice of Request for Comment regarding a Proposed NASAA Model Rule Exempting Certain Merger & Acquisition Brokers from Registration Pursuant to State Securities Acts](#) (January 2015).

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