WINSTON & STRAWN LLP

CLIENT ALERT

New M&A Broker Exemption: Federal Statutory Relief for Qualifying M&A Brokers

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On December 29, 2022, President Biden signed the Consolidated Appropriations Act, 2023 (H.R. 2617), which includes a provision exempting certain qualifying small business brokers ("**M&A Brokers**") from registering as a broker-dealer ("**M&A Exemption**") with the Securities and Exchange Commission ("**SEC**"). The M&A Exemption will go into effect on March 23, 2023.

Introduction

Generally, federal and state securities laws require that any person engaged in the business of effecting securities transactions for the accounts of others be registered as a "broker" under the Securities Exchange Act of 1934 ("**Exchange Act**"). Such requirements have previously raised concerns regarding business brokers and other financial advisors who assist clients in the sale of privately held businesses through the sale of their securities, as such parties may fall within the definition of "broker," requiring registration with the SEC. However, since 2014, M&A Brokers have relied on a no-action letter published by the SEC ("**No-Action Letter**") to engage in the business of effecting M&A securities transactions of privately held companies without registering as a broker with the SEC.

As background, Section 15(a) of the Exchange Act requires securities brokers to register with the SEC and Section 15(b) of the Exchange Act specifies 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 Exemption provides a statutory federal exemption for qualifying M&A Brokers from registering with the SEC by amending Section 15(b) of the Exchange Act to add a new subsection (13), "Registration Exemption for Merger and Acquisition Brokers."

The M&A Broker Exemption

The M&A Exemption defines an M&A Broker as 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***, 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. An M&A Broker relying on the M&A Exemption must reasonably believe that:

- upon consummation of the transaction, any person acquiring securities or assets of the eligible privately held company, acting alone or in concert, (i) will ***control*** the company or the business conducted with the assets of the eligible privately held company and (ii) be actively involved in its management (e.g., electing or serving as executive officers and approving an annual budget); and
- any person offered securities in exchange for securities or assets of the eligible privately held company 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, and results of operations for the period covered by the foregoing financial statements and material loss contingencies of the issuer.

An "**eligible privately held company**" is a privately held company that (i) does not have any class of securities registered, or required to be registered, under Section 12 of the Exchange Act (i.e., not subject to SEC reporting requirements), and (ii) has EBITDA of less than $25 million or gross revenues of less than $250 million or both in the fiscal year prior to the fiscal year in which the M&A Broker is initially engaged for the transaction (both determined in accordance with the company's historical financial accounting records).

The term "**control**" is defined as the power to direct, directly or indirectly, 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 under the M&A Broker Exemption

The M&A Exemption includes a list of "excluded activities" that fall outside of the exemption. An M&A Broker will be required to register as a broker under the Exchange Act, and may not rely on the M&A Exemption, if it engages in any of the following activities:

- receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties to the transaction.
- engages on behalf of an issuer in a public offering of any class of securities that is registered, or is 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).
- engages on behalf of any party in a transaction involving a shell company (other than a business combination related shell company).
- provides financing related to the transfer of ownership of an eligible privately held company.
- assists any party to obtain financing from an unaffiliated third party without complying with all other applicable laws in connection with such assistance and disclosing any compensation in writing to the party.
- represents both the buyer and the seller in the same transaction without providing clear written disclosure as to the parties the broker represents and obtaining written consent from both parties to the joint representation.
- facilitates a transaction with a group of buyers formed with the assistance of the M&A Broker to acquire the eligible privately held company.

- engages in a transaction involving the transfer of ownership of an eligible privately held company to a passive buyer or group of passive buyers.
- binds a party to a transfer of ownership of an eligible privately held company.

An M&A Broker may also not rely on the M&A Exemption if such broker (including, if applicable, any officer, director, or employee of such broker) has been barred from association with a broker or dealer under federal or state law or by a self-regulatory organization.

Important Observations

A few salient observations with respect to the M&A Exemption follow:

- The M&A Exemption does not pre-empt state "blue-sky" law registration requirements for M&A Brokers. Such blue-sky requirements will continue to apply to M&A Brokers that qualify for the M&A Exemption. Note, however, that the M&A Exemption may prompt states from adopting corresponding exemptions under each state's respective laws.
- Although the M&A Exemption provides that an M&A Broker need not register with the SEC, exempt M&A Brokers will still need to comply with the SEC's rules and regulations, including its anti-fraud provisions and potential enforcement actions.
- If a party is entering into an agreement with an M&A Broker relying on the M&A Exemption, such party should request representations and warranties related to such M&A Broker's compliance with the M&A Exemption. Similarly, to the extent an M&A Broker wants to rely on the M&A Exemption, such broker should consider the terms of each transaction to ensure that such transaction complies with the M&A Exemption.
- While the M&A Exemption and the No-Action Letter are similar, there are a few differences (e.g., size limitation of an eligible privately held company). Parties that previously relied on the No-Action Letter should consider the differences between its terms and the M&A Exemption to ensure continued proper reliance. It is also important to note that it is unclear whether the SEC will withdraw the No-Action Letter. If the No-Action Letter is withdrawn, it is possible that certain M&A Brokers, who previously relied on the No-Action Letter, may be required to register as a broker with the SEC.

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