Patience is a Virtue: Landmark Federal M&A Broker Exemption Effective March 29, 2023

Corporate News: A Legal Update

By Steven Sims on January 19, 2023

Business brokers and intermediaries who are active in the lower end of the M&A middle market have been lobbying Congress for 10 years to enact a limited exemption from broker registration under the Securities Exchange Act of 1934. Their work and patience have finally paid off. On December 29, 2022, President Biden signed into law the Consolidated Appropriations Act, 2023. Hidden away in it was Division AA, Title V, Small Business Mergers, Acquisitions, Sales & Brokerage Simplification, including the M&A Broker Exemption.

Under the M&A Broker Exemption, an "M&A broker" is generally exempt from broker registration. An M&A broker may engage in securities transactions in connection with the transfer of ownership of an eligible privately-held company ("EPHC"), whether structured as an asset sale, equity sale or a business combination, provided the M&A broker reasonably believes that any person(s) acquiring the securities or assets of an EPHC will "control" and be active in the management of the EPHC or its business. There is a presumption of "control" if the buyer(s) have the right to vote or power to sell 25% or more of a class of voting securities or, in the case of a partnership or LLC, have contributed or have the right to receive 25% or more of the capital. If there is an exchange of securities for the assets or securities of the EPHC there are mandatory financial disclosures to the seller.

An EPHC is a company with no registered securities or SEC periodic reporting requirements, which, for the fiscal year ending before engaging an M&A broker, had EBITDA less than $25 million or gross revenue less than $250 million.

An M&A broker is not exempt if it does any of the following: (i) takes custody of funds or securities to be exchanged; (ii) effects a public offering of securities; (iii) engages in a "shell company" transaction (other than a "business combination related shell company"); (iv) provides financing; (v) assists in obtaining financing except in compliance with applicable laws and with written disclosure of the broker's compensation; (vi) represents both buyer and seller without informed consent; (vii) syndicates a group of buyers; (viii) facilitates a transfer of an EPHC to a passive buyer; or (iv) has the power to bind a party. There are also

disqualification provisions if the M&A broker or any associate have been barred from association with a broker by the SEC, any state, or any self-regulatory organization, or are suspended from association with a broker.

The cost-benefit equation for registration of M&A brokers has never made a lot of sense. The lack of legal clarity also created uncertainty about the enforceability of M&A broker fee agreements. Although there is more work to be done at the state level, there is now a landmark federal M&A broker exemption which clarifies the rules and recognizes the valuable service M&A brokers provide.

(The North American Securities Administrators Association ("NASAA") adopted a model M&A broker State rule in 2015. To date, 12 states have adopted the model rule. Another 8 states' regulators have granted transitional exemptive relief by order or no-action letter. Nevada is in the rulemaking process to adopt NASAA's model rule.)

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