

New Federal Exemption For M&A Finders and Brokers

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On March 29, 2023, a long-awaited federal exemption for M&A finders and brokers took effect through the addition of Section 15(b)(13) of the Securities Exchange Act of 1934 (the "Exchange Act"). The exemption was signed into law on December 29, 2022 as a policy rider to the [Consolidated Appropriations Act of 2023 \(H.R. 2617\)](#) (the "Exemption"). As such, M&A finders and brokers will now be able to take advantage of a new statutory exemption from SEC registration as a broker-dealer for facilitating securities transactions in connection with the transfer and ownership of a privately held companies.

Background

Under the rules applying to securities broker-dealers, any person engaged in the business of effecting securities transactions for others must be registered as a broker under Section 15(b) of the Exchange Act. However, brokers and finders who specialize in the purchase or sale of private companies ("M&A Finders and Brokers") do not fit squarely within the definition of "broker". Nonetheless, many M&A transactions involve the purchase of shares, share for share exchanges, or other securities transactions, and facilitating these transactions could result in finders and brokers falling within the definition of "broker" and thus being subject to regulation despite the controversial application of the rule to these persons.

[Carter Ledyard & Milburn obtained the 2014 SEC No Action Letter](#) which M&A finders and brokers have been relying on ever since as a basis for acting in non-public M&A transactions without registering as a broker (the "2014 NAL"). This letter stated that brokers who limit their business to facilitating M&A transactions involving privately held companies would not be required to register as a broker if certain conditions were met. Moreover, brokers who relied on this letter had to meet a number of additional requirements, including that the transaction had to result in the buyer acquiring and exercising control of the private company, and that any securities issued in the transaction would be restricted securities. After the issuance of the 2014 NAL, in 2015, [the North American Securities Administrators Association \("NASAA"\) adopted a rule modeled after the 2014 NAL](#) as a recommendation for states across the country (the "Model Rule").

The 2014 NAL provided much needed clarity for what had been a grey area in the broker-dealer regulatory realm. However, in light of the newly anticipated Exemption, the [SEC found it appropriate to withdraw the 2014 NAL on March 29, 2023, effective immediately](#), due to the fact that the new exemption allows M&A Brokers "to engage in conduct that is largely similar to that discussed in the M&A Broker Letter, subject to certain additional conditions and limitations". In essence, the new Exemption codifies and replaces the 2014 NAL while also implementing new requirements for M&A finders and brokers who intend to qualify for an exemption from securities broker registration.

Who is an M&A Broker?

The Exemption defines an M&A broker as 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."

The M&A broker relying on the Exemption must reasonably believe that upon the closing of the transaction any person acquiring securities or assets of the eligible privately held company, acting alone or in concert with others, will: (a) control the eligible privately held company or the business conducted with the assets of the eligible privately held company and (b) be directly or indirectly active in the management of the eligible privately held company or the business conducted with the assets of the eligible privately held company.

The Exemption conforms with the 2014 NAL by limiting its application to transactions whereby the buyer obtains and exercises control over the private company. The requirement of control is met if the buyer acquires at least 25% of the voting power of the target company, or, in the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 25% or more of the capital. These control thresholds depart from the example set by the Model Rule which is set at 20% compared to the 25% in the Exemption.

What is an Eligible Privately Held Company?

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 or finder are initially engaged for the transaction: (a) no class of securities registered or required to be registered under Section 12 of the Exchange Act (i.e. it is not a public reporting company), and (b) EBITDA less than US\$25 million and/or gross revenues less than US\$250 million. These size limitations for eligible companies are consistent with the Model Rule but were a significant departure from the 2014 NAL as it did not impose any size limitation on private companies.

Excluded Activities and Disqualification

The M&A Exemption also includes a list of activities that would fall outside of its application and would continue to require registration as a broker. An M&A finder or broker relying on the Exemption must refrain from the following activities: having custody of the buyer or seller’s funds or securities, engaging in any public offering of securities as part of the transaction, providing financing for the transaction, assisting in obtaining financing from an unaffiliated third party unless any compensation for such arrangement is fully disclosed to the parties and the financing arrangement otherwise complies with applicable laws, facilitating a transaction involving a shell company (other than a shell company formed solely to effect a business combination or reincorporation), representing both the buyer and the seller unless they have provided written consent after receiving appropriate disclosures, forming a consortium of buyers, facilitating a sale to a passive buyer or group of buyers, and acquiring authority to bind either the seller or the buyer.

Key Takeaways

M&A finders and brokers currently relying on the 2014 NAL must now rely on the new federal Exemption to engage in certain M&A activity without violating the Exchange Act’s broker-dealer registration requirement. It is therefore important for parties to understand the newly imposed limitations in comparison to the 2014 NAL, which can be most notably seen through the inclusion of a limitation on the size of an eligible privately held company.

Parties acting in reliance on the Exemption should also be aware that there are still significant drawbacks to its application. First, it does not apply to state broker-dealer registration requirements. The activity of securities brokers can still be regulated by the individual states, some of which may already have an exemption in place. As a result, activities that are permissible under the Exemption may still be prohibited without registering as a broker-dealer in many states. The Model Rule would largely bridge this gap. However, only a minor number of states have adopted some version of the rule. It is still unclear whether the NASAA will amend its model rule or whether state securities regulators will amend existing rules or adopt new rules consistent with the Exemption. Second, the size limitation on eligible private companies results in the Exemption being unavailable for transactions involving private companies that exceed the \$25 million cap on EBITDA and/or the \$250 million cap on revenues. Accordingly, M&A finders and brokers, issuers, privately held companies and other market participants should continue to

consider whether certain M&A activity they are facilitating qualifies for the application of the Exemption and whether that activity may trigger state registration requirements.

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