New Federal Registration Exemption for M&A Brokers of Eligible Businesses

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The Securities Exchange Act of 1934 has recently been amended to exempt "M&A brokers" from registering with the Securities Exchange Commission (SEC) when facilitating qualifying securities transactions.[1] The rule change was instituted to simplify small and middle market transactions, reducing time and expense to buyers, sellers, and brokers.

Until recently, M&A brokers have tentatively relied on a 2014 no-action letter in which the Division of Trading and Markets explained that it would not recommend enforcement to the SEC in connection with limited securities transactions involving a change of control of a privately held company by an unregistered broker. The no-action letter was specifically limited to its facts and circumstances, and left questions regarding its scope and implications. In light of the 2023 federal exemption, the 2014 has now been withdrawn.

The new amendment enables qualifying brokers to continue facilitating certain transactions on behalf of the seller or buyer without having to register with the SEC and comply with the associated regulations. Unlike the 2014 rule, the amendment provides a formal statutory exemption for M&A brokers.

The New Federal Exemption Explained

The new exemption, which became effective in March 2023, is only available for M&A brokers participating in transactions which involve "eligible privately held company[ies]" that:

1. Are not subject to SEC reporting requirements.
2. And have *either*:

   - EBITA (earnings before interest, tax, and amortization) less than $25 million in their last complete fiscal year.
   - Gross revenue less than $250 million in their last complete fiscal year.

The exemption does not apply to M&A brokers performing the following activities:

- Having custody of the buyer's 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. (Unless formed solely to effect a business combination or reincorporation.)
- Representing both the buyer and the seller. (Unless both sides have provided written consent after receiving appropriate disclosures.)
- Organizing buyers in a consortium.
- Facilitating a sale to a passive buyer.
- Binding either the seller or buyer to the transfer of ownership.

An M&A broker who is not disqualified and does not engage in the excluded activities above will be exempt from SEC registration related to eligible privately held companies.

Impact on Alternative Exemptions

The exemption should not affect an M&A broker's ability to facilitate exempt offerings and private placements under prior exemptions but may add flexibility or reduce regulatory burdens where a prospective sale of securities may be exempt under multiple overlapping exemptions.

The exemption does not modify the scope of other exempt offering and private placement rules, including commonly used Rules 504 and Rule 506 of Regulation D under the Securities Act of 1933.

To qualify an offering under Rule 504, a broker of securities must therefore still meet the substantive requirements for exemption (*e.g.*, aggregate offering price may not exceed $10,000,000 within 12 months) and procedural/filing requirements (*e.g.*, file Form D with the SEC within 15 days of the first sale of securities). In some cases, it will make sense to pursue a specific private offering exemption under Regulation D where the realities of a transaction require a structure that would be excluded from the blanket new federal exemption. Examples include situations where a broker provides financing or organizes buyers for the purpose of acquiring an eligible business, etc.

But where a sale may qualify under multiple exemptions, M&A brokers and their clients will have greater flexibility in structuring sales of securities. Additionally, the new EBITDA and gross revenue thresholds provide simple metrics that, once satisfied, may be less vulnerable when timing accelerates or new (unaccredited) buyers become involved, which can cause a transaction to potentially fail under rules 504 and 506, respectively.

The new exemption may also help to reduce the costs and regulatory burdens by eliminating the time and expense related to preparation and filing of Form D. While the SEC does not charge a fee for Form D filing, most states do. State filing fees vary widely, and so do the states' formulas for calculating their fees, often requiring lengthy and repetitive exercises by brokers, lawyers, and clients to ensure compliance.

The new federal exemption will therefore add flexibility in structuring intra- and interstate private offerings and offer alternatives that reduce regulatory filing requirements and related costs.

Critics Say Amendment Compromises Integrity, Anti-Crime Measures on Larger Deals

Critics have charged that the exemption is overly broad, and that its quantitative thresholds are too high. Some commenters contend that the actual dollar figure ranges designated for the exempted transactions ($25 million in EBITDA or $250 million in gross revenues) are too high and should be revised to lower thresholds. Proponents of a revised exemption have suggested thresholds around $1-5 million in EBITDA and $10-50 million gross revenues).

The arguments for revising the new rule to significantly reduce the quantitative exemption thresholds relate to concerns that experienced (and SEC-registered) broker-dealers may be needed to competently facilitate larger and more complex deals involving larger companies.

On the other hand, parties pursuing deals at the lowest end of these thresholds may require the most protection. As dollar values increase, competition, sophistication, and risk awareness tend to also increase. Parties to higher value transactions are generally better able to evaluate risk and hire competent advisors. By specifically excluding certain activities from the exemption, the drafters clearly anticipated concerns such as unsophisticated acquisition groups or passive investors.

Considerations Regarding State Level Broker Registration

Note that the new federal exemption applies to SEC requirements. The new rule does not preempt state level registration requirements for M&A brokers. Therefore, M&A brokers who are exempted from SEC registration under the new amendment may still be required to register with securities regulators in some states.

Several states have mirrored their requirements to the federal rule, exempting M&A brokers from their registration requirements. It is unclear how many states will follow suit.

Seek Good Advice

The new federal exemption to the Securities Exchange Act has reduced some of the burdens related to sale transactions involving certain privately held entities. But the small and midsized M&A market is as competitive and complex as ever, requiring a holistic and thoughtful business/legal approach.

When considering buying or selling a business, consult an experienced M&A attorney. Foster Swift attorneys are skilled and experienced in corporate, contract, securities, and tax issues that are essential to any successful deal.

We routinely advise in key areas, including:

- Business Lifecycle and Deal Structuring – Our attorneys help clients identify risks, advantages, and efficiencies in corporate and business transactions (merger, acquisition, spin-off, etc.), weighing competing objectives and achieving their goals.
- Due diligence – It is essential in any deal to define what is being bought and sold and identify assets and risks that need to be allocated. In a stock sale, where liabilities generally pass with ownership, allocation involves careful drafting and negotiation of indemnities and other risk-allocation provisions like escrow agreements, earn-outs, and holdbacks. Agreements with customers and affiliates may restrict a seller's ability to transfer without prior consent. Likewise, a buyer may require third-party consents or stakeholder approval to engage in certain transactions. Due diligence is therefore essential in identifying, allocating, and documenting these risks.
- Drafting/Negotiating Agreements – M&A attorneys should generally help to draft, understand, and negotiate necessary transaction documents. Transactional documents often include complex terms and conditions, inter-related agreements, schedules, and exhibits; technical definitions, or other subtle language that may be difficult to understand. In structuring and negotiating these issues, experience is key.

Foster Swift's Business and Tax lawyers are ready and eager to assist business owners, executives, and managers in planning and executing any transaction.

If you have any questions on the new SEC rule or if your business is considering an M&A move, contact Nick Stock at nstock@fosterswift.com and 616-726-2255.

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[1] *See Securities Exchange Act of 1934, Section 15(b)(13)(E)(iv) (defining "M&A broker").*