Broker-Dealer Regulatory Update

Congress Provides New Federal Exemption for M&A Brokers, SEC Rescinds No-Action Letter

May 4, 2023

The recently-enacted Consolidated Appropriation Act amends the Securities Exchange Act of 1934 ("**Exchange Act**") to exempt certain brokers that specialize in the purchase and sale of privately-held companies ("**M&A Brokers**") from broker-dealer registration requirements under Section 15(a) of the Exchange Act (such exemption, the "**M&A Broker Exemption**").[1] Previously, M&A Brokers could rely on no-action guidance published and revised in 2014 ("**M&A Broker No-Action Letter**")[2] by the staff of the Securities and Exchange Commission ("**SEC**") to engage in the business of effecting M&A securities transactions of privately-held companies without registering as a broker with the SEC. The M&A Broker Exemption became effective and the M&A Broker No Action Letter was rescinded in March 2023. As discussed below, the M&A Broker Exemption is only available for transactions involving small privately-held companies, whereas the M&A Broker No-Action Letter permitted reliance for all privately-held companies. Persons previously relying on the M&A Broker No-Action Letter should review the availability of the M&A Broker Exemption to their practices as they may need to consider changing business practices or registering as a broker with the SEC.

Background

Section 3(a)(4)(A) of the Exchange Act defines the term "broker" to mean "any person engaged in the business of effecting transactions in securities for the account of others." A person who effects the sale of all or a controlling interest in an operating business through a securities transaction is generally deemed to be effecting the sale of securities and is therefore a "broker" pursuant to section 3(a)(4) of the Exchange Act.[3] Consequently, such person would be required to register as a broker. Registering as a broker is a costly and time consuming process which significantly increases the regulatory footprint of the registrant.

In 2014, the SEC staff issued the M&A Broker No-Action Letter, which permitted an M&A Broker, subject to several conditions, to engage in the business of effecting securities transactions in connection with the transfer of ownership and control of a privately-held company to a buyer that will actively operate the company or the business conducted with the assets of the company. For these purposes, a privately-held company is a company

1 Codified in Section 15(b)(13) of the Exchange Act.

2 Faith Colish, Esq., Arter Ledyard & Milburn LLP, et al., SEC No-Action Letter (February 4, 2014, rescinded March 29, 2023).

3 In 1985, the U.S. Supreme Court held that the sale of all or a controlling interest in a business involves the a sale of "securities" within the meaning of the Securities Act of 1933. 471 U.S. 681 (1985); 471 U.S. 701 (1985). Alternatively, if a transaction is structured as an asset sale rather than a stock sale, then such transaction does not involve the sale of securities, and such person would not meet the definition of "broker" under the Exchange Act.

that does not issue any class of securities registered, or required to be registered, under Section 12 of the Exchange Act or does not file, or is not required to file, periodic reports under Section 15 of the Exchange Act.

The M&A Broker Exemption

Unlike the M&A Broker No-Action Letter, the M&A Broker Exemption creates a statutory exemption from SEC registration requirements under the Exchange Act for M&A Brokers.[4] Importantly, in a significant departure from the M&A Broker No-Action Letter, the M&A Broker Exemption caps the eligibility of privately-held companies to an ***EBITDA of less than $25 million and gross revenues of less than $250 million in such company's prior-year***. Accordingly, persons wishing to avail themselves of the M&A Broker Exemption will only be able to do so if the target privately-held company has an EBITDA and gross revenues under these amounts, which are subject to change by the SEC over time.

In addition to these size limits, the M&A Broker Exemption is available if the M&A Broker ***does not***:

1. have custody over any securities to be exchanged by the parties;
2. transact with any public offering of securities;
3. engage in a transaction involving a shell company (*i.e.*, company with no or nominal operations, and has (i) no or nominal assets, (ii) assets consisting solely of cash and cash equivalents, or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets);
4. provide financing directly or indirectly for the transaction;
5. assist in obtaining financing from an unaffiliated third party without complying with all applicable laws and disclosing compensation;
6. represent both parties unless the parties provided written consent after receiving appropriate disclosure;
7. assist with the formation of a group of buyers;
8. facilitate a transaction with a passive buyer or a group of passive buyers; and
9. bind any party to a transfer of ownership. Further, as with the no action guidance, an M&A Broker may not avail itself of the M&A Broker Exemption if it has been barred from association with a broker or dealer by the SEC, any state or any self-regulatory organization or has been suspended from association with a broker or dealer.

[4] The term "M&A broker" means, subject to certain conditions, "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 . . ."

Blue Sky Limitations of the M&A Broker Exemption

The M&A Broker Exemption does not preempt state law broker registration or other state law requirements. While the creation of this statutory regime helps to solidify the federal stance on this issue, it is important to note that M&A Brokers may still need to consider state securities laws and regulations. The North American Securities Administrators Association ("**NASAA**") drafted a model rule that addresses the disparity, creating a state-level correlating exemption; however, not all states have adopted the NASAA model rule. Therefore, M&A Brokers should also consider the applicable state requirements for each state in which they conduct business. While the regulations may change over time, it would be prudent to review practices and consult with a legal professional before engaging in M&A activities as a broker or consultant.

For further information regarding this Update, please contact the following authors:

WASHINGTON, D.C.

David W. Blass
+1-202-636-5863
david.blass@stblaw.com

David Nicolardi
+1-202-636-5571
david.nicolardi@stblaw.com

NEW YORK CITY

Meredith J. Abrams
+1-212-455-3095
meredith.abrams@stblaw.com

Manny M. Halberstam
+1-212-455-2388
manny.halberstam@stblaw.com

Amanda H. McGovern
+1-212-455-2167
amcgovern@stblaw.com

Jeffrey Caretsky
+1-212-455-7764
jeffrey.caretsky@stblaw.com

William LeBas
+1-212-455-2617
william.lebas@stblaw.com

Humza Rizvi
+1-212-455-7654
humza.rizvi@stblaw.com

HOUSTON

Minzala G. Mvula
+1-713-821-5617
minzala.mvula@stblaw.com

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