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Congress Passes New "M&A Broker" Exemption from Registration Requirements

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Congress recently passed an exemption from the federal securities laws that may make it easier for certain small businesses to raise capital and be sold in a change of control transaction. This "M&A broker" exemption was part of the Consolidated Appropriations Act of 2023 (H.R. 2617) and will become effective ninety (90) days after enactment, on March 29, 2023. The new statute enacts into federal law the Securities and Exchange Commission's 2014 *M&A Brokers* no-action letter. The no-action letter exempts "M&A brokers" from registration as broker-dealers under the federal securities laws if they assist small businesses in capital raising and sales that involve a change of control and if certain detailed conditions are met. The new statutory exemption is narrower than the no-action letter and does not preempt state law registration requirements for broker-dealers.

The touchstone of federal and state broker-dealer registration requirements is the receipt by a broker or finder of transaction-based compensation, such as a fee or commission based on the amount of capital raised or the company's purchase price in an M&A transaction. Use of an unregistered broker can violate the Securities Exchange Act of 1934 and cause the transaction to be "void" giving a rescission right to the buyer.

The *M&A Brokers* no-action letter and the new statutory exemption permit such engagements if lengthy requirements are met. The new exemption applies to change of control transactions of privately held companies, including both capital raising and the sale of the business. Most importantly, the broker must reasonably believe that the person acquiring the securities or assets of the company will (a) control the Company or the business conducted with the assets of the company, and (b) be active in the management of the Company or the business conducted with the assets of the company. The company must be privately held and have EBITDA of less than $25 million and/or gross revenues of less than $250 million. "Control" means the buyer will have the power to vote or direct the sale of at least 25% of the shares of the privately held company. "Active in the management" means the buyer will have the ability, for example, to elect executive officers or serve as an executive.

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The new exemption operates as essentially the codification of the *M&A Brokers* no-action letter. A significant difference is the limitation on the size of the eligible Company (i.e., the EBITDA and/or gross revenues maximum) and the loosening of the requirement of actual control of the company by the buyer to merely a reasonable belief.

Note that, while a few states have adopted the *M&A Brokers* no-action letter exemption in some form, many have not, including Arizona. Any unregistered broker must comply with applicable state law as well as the federal exemption, and these may differ in important respects.

Although the new federal statutory exemption for M&A brokers will ease access to capital and M&A transactions for some small businesses, the limitations and conditions of the new statute and the need to comply with state law will limit the usefulness of the new exemption and require great care on the part of companies and their corporate counsel.

If you have any questions about the new federal M&A broker exemption, don't hesitate to contact your Kutak Rock attorney or any member of Kutak Rock's Scottsdale Corporate and Securities Group. You may also visit us at www.kutakrock.com.