To: Corporations, Securities & Financial Institutions Committee and the Business Law Section Executive Council

From: Chapter 517 Task Force, Stuart R. Cohn Chair

Re: Recommendation to Support Florida’s Office of Financial Regulation Ch. 517 Reform Legislation

Date: August 4, 2021

**Background:**

Fl. Stat. Ch. 517, the Florida Securities and Investor Protection Act (the “Act”), has remained substantially unchanged for many years despite major developments in federal securities laws and the modernization of securities laws in other states. As a result, Florida-based businesses do not have capital-raising opportunities that are available in other states. In addition, investor protection provisions in the Act need to be updated and improved. Recognizing these deficiencies, the Corporations, Securities & Financial Services committee of the Business Law Section formed several task forces over the years to undertake reform efforts., but their efforts were stymied by the Florida Division of Securities’ benign neglect or opposition to reform proposals.

In April 2021, Russell Weigel, Commissioner of Florida’s Office of Financial Regulation (OFR), in which the Division of Securities is located, called Stuart Cohn to ask whether the Business Law Section would be interested in assisting OFR’s effort to present proposed legislation that would materially reform Ch. 517. The Commissioner, who in his private life was an attorney practicing securities law, is aware of the shortcomings in Florida’s statute and is determined to present reform proposals. A proposed bill offered by the OFR in the prior legislative session failed at the staff level, as the proposal was not sufficiently clarified and documented.

Following up on the Commissioner’s request, at the June meeting of the C,S & FI Committee there was proposed the formation of a Ch. 517 Task Force for the purpose of assisting the OFR in its development of reform legislation. The proposal was approved by the Committee and subsequently by the Business Law Section Executive Council.

The Task Force members are listed below. In addition, we have had the able assistance of two BLS Fellows, Chemere Ellis and Katherine Van de Bogart. The Task Force met numerous times with the Commissioner and his staff through internet meetings, obtained drafts and redrafts of OFR’s proposed legislation, examined provisions in other states, exchanged emails and proposed revisions, and discussed at length the various reform proposals.

As a result of the joint efforts by the Task Force and OFR, the OFR has a proposed bill that contains numerous important reform measures. While there remain additional measures that may be considered for future adoption, the Task Force believes that the OFR’s proposed legislation materially improves Florida’s securities Act, creates needed capital-raising opportunities for Florida-based businesses, and strengthens investor protection measures. The Task Force has considered and approved the OFR proposed bill and recommends that the bill be supported by the Business Law Section. The proposed legislation amending the Act is attached to this memorandum.

**List of Principal Reform Measures**

The principal reform measures of the OFR bill, discussed in detail below, are:

1. **Registration Exemptions**:
2. Substantially revises the intrastate crowdfunding exemption.
3. Adopts an Accredited Investor exemption.
4. Amends the current limited offering exemption in Ch. 517.061(11)
5. **Registration of Securities**:
6. Allows for coordinated review with other states of federally registered offerings.
7. Eliminates the ambiguous “fair, just and equitable” merit review standard while maintaining substantive disclosure and qualification requirements.
8. Allows the issuer to “test the waters” and engage in “demo day” presentations to prospective investors.
9. **Registration of Finders**: Defines and provides for licensing of “Finders”.
10. **Notice Filing**: Provides for Notice Filing in Florida of certain federally exempt offerings.
11. **Enforcement Provisions**:
12. Adds control person liability for OFR enforcement actions.
13. Adds aider and abettor liability for OFR enforcement actions.
14. Allows the OFR to recover costs and attorney’s fees in enforcement actions.
15. **Definition Amendments:** Adds to and clarifies existing definitions of terms used in the Act.

**Description of Reform Measures**

**(A) Registration Exemptions**

**1.Reform of the Crowdfunding Exemption (s. 517.0611)**

Section 5 of the 1933 Securities Act requires that all offerings of securities be federally registered unless an exemption from registration exists. Section 5 applies to any offering that utilizes an instrument of interstate commerce and has no minimum or de minimis exceptions. Smaller companies and start-ups cannot afford the time and expense of registered offerings and therefore must look to exemptions for capital-raising purposes. The exemption most used is SEC Rule 506(b), a private offering exemption that forbids general advertising and solicitation of the offering and limits the number of non-accredited investor purchasers. Smaller companies often do not have the capacity to comply with the limitations of Rule 506(b). A companion exemption, Rule 506(c), allows for general advertising and solicitation but purchasers are limited to accredited investors.

In response to the concern that smaller companies and start-ups need a more workable exemption from registration, a federal exemption was adopted in 2015 for internet-based crowdfunding offerings. The exemption grew out of the internet crowdfunding phenomenon and is therefore referred to as the crowdfunding exemption. Although the exemption, set forth at 17 C.F.R. 227.100 to 227.503, provides for federal preemption of state registration laws, the federal crowdfunding exemption is so replete with technical, onerous requirements that it has proved to be of little value to smaller companies needing to raise capital.

As a result of the failure at the federal level to create a viable, workable crowdfunding exemption, nearly every state has adopted an exemption from state registration for relatively small intrastate offerings. The state crowdfunding exemption is conditioned on compliance with the federal exemption for intrastate offerings contained in Section 3(a)(11) of the Securities Act of 1933 and SEC Rules 147 and 147A, which means that the securities offering must be by a company principally located within the state and the sales of securities must be limited to the residents of the state.

Following the national trend, Florida adopted an intrastate crowdfunding exemption in 2015. Fl. Stat. Ch. 517.0611. Unfortunately, Florida’s legislation did nothing more than mirror the federal requirements which have proven to be of very limited usefulness. As a result, to date there has not been a single securities offering under Florida’s crowdfunding statute. The OFR proposed reform measures would bring Florida’s crowdfunding exemption in line with similar exemptions in other states and will open opportunities for smaller companies to raise capital within a much more reasonable and workable regulatory framework. We have been advised, for example, that there have been numerous offerings in Georgia under their crowdfunding provisions that are substantially similar to the OFR’s reform proposals.

The principal reform elements to the crowdfunding exemption are:

1. **Expands companies eligible to use the exemption** by eliminating the requirement that the company be incorporated in Florida. Therefore, a Florida-based corporation or LLC formed in another state, such as Delaware, can raise capital under this exemption provided that Florida is the company’s principal place of business as determined by objective criteria set forth in SEC Rule 147A.
2. **Increases the amount a company can raise** under the exemption within a 12-month period from $1 million to $5 million. The SEC recently amended its crowdfunding exemption to allow for a $5 million maximum amount. In today’s economy, limiting a company to raising $1 million in a 12-month period may be too restrictive for many businesses.
3. **Sets a flat $10,000 maximum that a non-accredited investor can invest** in crowdfunding offerings in a 12-month period. This proposal avoids the confusion of the formula-based limitations in the current statute. For accredited investors, there is no investment limitation in the current statute or the proposed bill.
4. **Eliminates the requirement that the offering be administered by a dealer or an intermediary**. The requirement that the issuer employ a third-party dealer or registered intermediary to administer the offering may be the greatest impediment to the use of the crowdfunding exemption, as it is costly to the issuer and hinders the ability of the issuer to market its offering. Nearly every other state exemption has eliminated this requirement. The issuer may choose to use an intermediary, in which case the OFR proposal contains in s. 517.12 provisions for the registration of the intermediary and sets forth the intermediary’s statutory obligations. If the issuer chooses not to use an intermediary, the issuer is obligated to perform the duties that would otherwise be performed by an intermediary, including assuring that the investors are advised of the risks of the offering, are qualified, and that the disclosure materials are given to all potential investors.
5. **Eliminates the mandatory third-party escrow of funds**. The current statute requires that the issuer set a minimum target amount and that all proceeds from the sale of securities be deposited with a third-party escrow agent until the target amount has been reached. While seemingly unobtrusive, in practice the escrow requirement is a major impediment for smaller companies. The OFR reported, and Task Force members confirmed, that banks and other institutions are not willing to serve as escrow agents for small companies for reasons of administrative costs and potential liabilities. The OFR proposal allows the issuer to use a third-party escrow agent. Alternatively, the issuer is required to deposit the proceeds in a federally insured bank until the target amount has been reached. If the target amount is not reached within a pre-determined, disclosed time period, the issuer is obligated to return all funds to the investors.
6. **Allows general solicitation and advertising**. The current statute has no provision that permits the issuer to solicit potential investors and use general advertising, other than through an intermediary. The proposal allows the issuer to engage directly in general solicitation and advertising of the offering, provided that all communications limit the target audience to residents of the state.
7. **“Demo day” presentations**. The issuer is permitted to engage in carefully prescribed “demo day” meetings with potential investors in accordance with conditions analogous to those set forth in recently adopted SEC Rule 148. Such meetings are limited in terms of sponsors, must involve more than one issuer, there are strict limitations on issuer communications, and cannot involve any investment recommendations, negotiations or commitments.
8. **Eliminates required annual reports to investors**. The OFR proposal eliminates this requirement. No other exemption from registration has this requirement, and both the corporation and limited liability company statutes allow for inspection of financial statements and other records by shareholders or members.
9. **Three-day voidability provision**: This provision, contained in Florida’s limited offering exemption in Ch. 517.061(11), is proposed to be added to the crowdfunding statute. It allows an investor to rescind the transaction within the latter of 3 days after (i) purchase or (ii) being advised of the right to rescind. The Task Force recognizes that this provision may be a trap for the unwary issuer, but it has long been a part of Florida’s securities laws and is an investor protection measure.
10. **Financial statement disclosures**. The proposed bill retains the substantial disclosure obligations of issuers to prospective investors. Because of the change in maximum offering amounts, the financial disclosure obligations have been revised for differing offering amounts and clarified as to the required types of financial statements.

2**.Adoption of an Accredited Investor Exemption (s. 517.061(23))**

The proposed bill adopts the Accredited Investor exemption developed by the North American Securities Administrators Association. This state registration exemption has been adopted by most states. It is limited to accredited investors residing in the state, contains substantial issuer disqualification provisions, cannot be used by so-called “blank-check development companies,” and substantially limits the resale of securities by purchasers. The state exemption avoids federal registration by qualifying under the federal exemption for intrastate offerings.

Many companies raise capital through SEC Rule 506, the federal private offering exemption that preempts state law. Rule 506(b), however, does not permit any form of general advertising or solicitation. This can hinder a small company’s capacity to find accredited investors. The state accredited investor exemption allows for general advertising and solicitation under limited conditions. Rule 506(c), an alternative exemption, permits general advertising and solicitation, but that exemption is relatively under-utilized because of its stringent requirements for verifying the accredited investor status of each purchaser.

The state Accredited Investor exemption is conditioned on the issuer’s, or issuer’s agent’s, reasonable belief that the prospective purchaser is an accredited investor, which is the traditional Rule 506(b) standard. The Accredited Investor exemption may therefore prove very useful for local companies who need to engage in some general advertising or solicitation in order to attract potential investors.

Adoption of the Accredited Investor exemption also allows both Florida and out-of-state issuers that wish to take advantage of the SEC Rule 504 federal exemption to offer the securities to Florida residents under the Accredited Investor exemption without the need to register the offering in Florida.

3**.Amendments to the Current Limited Offering Exemption (s. 517.061(11))**

The proposed bill makes two major changes to the exemption set forth in Ch. 517.061(11), Florida’s current limited offering exemption:

1. **Integration**: The provisions relating to the integration of the offering with other offerings have been eliminated. Instead, the bill provides that the Commission will adopt by rule new provisions that are in substantial compliance with recently adopted SEC Rule 152. Rule 152 significantly reduces the threat to companies, especially smaller ones that have continuing and sporadic needs for capital, that multiple offerings will be integrated as one, with the result that otherwise distinct valid exempt offerings will be deemed in violation of the registration provisions. The OFR’s proposed bill has an effective date of October 1, 2022, which allows for considerable time for the Commissioner’s office to adopt reasonable integration guidelines along the lines of Rule 152.
2. **Limited “Demo Day” Solicitation**: Although the limited offering exemption prohibits “any form of general solicitation or general advertising in this state,” the proposed bill allows for issuers to participate in “demo day” presentations in accordance with the provisions of recently adopted SEC Rule 148. The presentations can only be at meetings sponsored by certain limited organizations, such as universities, state or local instrumentalities, business incubators, or defined angel investor groups, must involve more than one issuer, issuer communications are strictly limited, and there can be no investment recommendations, advice, negotiations or commitments. The ability to engage in this limited form of public disclosure is important for smaller companies and start-ups trying to attract potential investors.

**(B) Registration of Securities**

These proposals apply to offerings that are registered in Florida, including federally registered offerings and offerings that are only state registered (such as registered intrastate offerings).

**1. Coordination with Other States (s. 517.081(1))**

Federally registered offerings are also registered in every state where an offering will be made, and each state has authority to review the offering under its merit review and other substantive standards. The bill allows the Commission to adopt rules for the cooperation and coordination with other states in the review process of federally registered offerings. It is important for the issuer, and for each state, that there be some coordination among states to avoid duplication, costs, and timing concerns. Many states have entered into state coordinating processes, and the proposed bill allows Florida to be part of the process. The proposal does not impact Florida’s ability to impose its own standards of review on the offering.

**2.Elimination of the “fair, just and equitable” merit review standard (s. 517.081(7))**

The bill eliminates the “fair, just, and equitable” standard as part of the review process for registered offerings. Florida is among a minority of states that continues to have this ambiguous standard embodied in its statute. The “fair, just and equitable” has long been considered too vague to be a workable standard.

Consistent with other states, the bill retains the ability of the OFR to deny registration to offerings that fail to meet state-mandated disclosure standards or that the OFR believes may be fraudulent or tend to work a fraud on investors. The commission is also authorized to adopt rules that relate to substantive, investor-protection aspects of the offering, such as the relative amounts of promoter and investor equity. Florida currently has in its Administrative Code several such provisions that conform to investor protection standards adopted by the North American Securities Administrators Association.

**3.”Testing the Waters” and “Demo Day” Communications (ss. 517.081(11)-(12))**

Consistent with recent SEC rules, the proposed bill allows issuers to “test the waters” by engaging in pre-offering oral or written communications with prospective investors to determine whether there is any interest in a contemplated securities offering. The ability to determine in advance the likelihood of investor reaction to a contemplated offering can save a company from the considerable time and expense of an unsuccessful offering. There cannot be any solicitation or acceptance of money or other consideration, nor any commitment from any person to purchase the contemplated securities.

The communication can also be made at a “demo day” presentation as described above in Item A.3(2) regarding the limited offering exemption. Both the “testing the waters” and “demo day” communications are deemed to be an “offering” and are therefore subject to the anti-fraud, civil and criminal penalty provisions set forth in Ch. 517. Misleading disclosures or omissions of material information made through such communications may therefore subject issuers to Florida’s civil, administrative and criminal lability provisions.

**(C) Registration of Finders (s. 517.12(20))**

The proposed bill requires the registration of certain defined “Finders” who are compensated by issuers to introduce or refer potential investors to issuers who the Finders reasonably believe to be accredited investors. Finders might not be dealers or investment advisers who are registered with the state, as their limited activities might not require such registration. Finders fall into a somewhat gray, unregulated area. Nevertheless, because they assist the issuer in finding investors and are compensated by issuers for doing so, the proposed bill adopts registration and disclosure requirements as investor protection measures. The SEC has also expressed concern about the activities of unlicensed finders and has set forth proposals for regulation. Those proposals have not yet been adopted.

Finders are defined in the bill to be natural persons or entities who reside or do business in Florida and who receive compensation in connection with an issuer’s offer of securities to introduce or refer accredited investors to the issuer. Such persons must apply for and be approved as registered Finders in the state under a detailed application process. A Finder cannot make any statement regarding the value or advisability of the investment. The Finder must also disclose to persons they refer to the issuer the type and amount of compensation that has or will be paid to the Finder in connection with the introduction or referral.

If adopted, Florida will be a leader among states in requiring the registration of Finders. While the current proposal is limited to specific types of investors, the Commissioner plans to continue to examine the “finder” issue and consider further registration requirements.

**(D) Notice Filing (s. 517.083)**

So-called “federal covered securities” listed in Section 18(b) of the 1933 Securities Act are exempt from state registration. The offerings are not, however, exempt from state filing and anti-fraud laws. The proposed bill requires that notifications and prescribed documents be filed with the OFR for certain offerings of federal covered securities, including the issuer’s consent to service of process. The OFR is given authority to suspend the sale of such securities if there is a failure to comply with the filing and notification requirements. The information obtained will also be used by the Commission to determine the amount of any fees that may be owed to the state by issuers.

**(E) Enforcement Provisions**

1**. Control Person Liability (517.191(4))**

The bill authorizes to the OFR to bring enforcement actions against control persons for violations by controlled persons unless the control person acted in good faith and did not directly or indirectly induce the acts that violated the statute.

2**.Aiding and Abetting Liability**  **(517.191(4))**

The bill authorizes the OFR to bring enforcement actions against any person who knowingly or recklessly provides substantial assistance to another person in violation of the statute.

**3.Recovery of Attorney’s Fees** (517.191(5))

The bill allows the OFR to recover costs and attorney fees related to the investigation or enforcement of the statute.

**(F). Definition Amendments (s. 517.021)**

The proposed bill adds several new terms to the definitions section and clarifies existing definitions.

**New Terms**

(a) “Accredited Investor” s. 517.021(1)

(b) “Control person” 517.021(8)

(c) “Finder” 517.021(12)

(d) “Natural person” 517.021(18)

(e) “Office” 517.021(20)

(f) “Person” 517.021(21)

**Amended Terms**

(a) “Associated Person” s. 517.021(3)

(b) “Dealer” s. 517.021(9)

(b) “Intermediary” s. 517.021(15)

(c) “Investment Adviser” s. 517.021(16)

**Miscellaneous Additional Changes**

The proposed bill contains numerous other changes to Ch. 517 that are less substantial but also salutary. Among such changes are

1. Reduction from 15 to 6 in the number of clients a person can have without having to register as an investment adviser. This conforms to the National Securities Markets Improvement Act.
2. Elimination of “issuer” from the definition of “dealer,” an unusual and unnecessary licensing requirement.
3. Inclusion of references to limited liability companies and managers in various registration and disclosure provisions.
4. Elimination of the exemption for limited partnerships from the requirement that registered offerings be priced higher than $5 per share.

**Conclusion and Recommendat*ion***:

This is an important bill from the OFR and represents the first set of major changes to Florida’s securities laws in many years. It:

 (1) improves the capacity of Florida-based companies to raise money in Florida by amending the crowdfunding statute, adding the Accredited Investor exemption, allowing for pre-offering testing of potential investor interest, and revising onerous integration provisions,

(2) adds investor protection measures through the Finder registration provisions and increased enforcement powers,

(3) allows Florida to coordinate its review process of registered offerings with those of other states, and

(4) clarifies and improves numerous provisions that are outdated or incomplete.

The Task Force believes that the proposed provisions are in the best interests of Florida companies and investors and recommends that the Business Law Section support the OFR proposed legislation.

**Chapter 517 Task Force:**

Chair: Stuart Cohn

Members: Valerie Angelucci, Dan Aronson, Rob Brighton, Francis Curran, Karen Orlin, Richard Leisner, Don Rett, Andrew Schwartz, Phil Schwartz, Michelle Suarez, Greg Yadley

BLS Fellows: Chemere Ellis, Katherine Van De Bogart