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State Blue Sky Concerns; Florida and New York

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

I have often written about state blue sky compliance and issues in completing offerings that do not pre-empt state law, including Tier 1 of Regulation A+ and initial or direct public offerings on Form S-1. I've also often expressed my opinion that the SEC, together with FINRA, is best suited to govern most securities-related registrations and exemptions, including both for offerings and broker-dealer matters, and that the states should be more focused on state-specific registrations and exemptions (such as intrastate offerings) and investigation and enforcement with respect to fraud or deceit, or unlawful conduct.

Despite the SEC support for the NASAA-coordinated review program to simplify the state blue sky process for securities offerings, such as under Tier 1 of Regulation A+, only 43 states participate. I say "only" in this context because the holdouts – including, for example, Florida, New York, Arizona and Georgia – are extremely active states for small business development and private capital formation. Moreover, even using the coordinated review program, the states have vastly different rules and interpretations of the same rules.

Blue sky compliance is tricky at best. In this blog I am discussing particular difficulties with the blue sky legislation in Florida and New York as an example of the types of traps an issuer can face without proper planning and, of course, competent legal counsel.

For a review of federal pre-emption of state securities laws, see my two-part blog on the National Markets Improvement Act of 1996 (NSMIA) HERE and HERE. For further information on the NASAA-coordinated review program, see my blog HERE for further discussion.

Florida

Florida does not have an issuer exemption from broker-dealer registration for public offerings, including offerings made under Regulation A/A+ or self-underwritten public offerings made using Form S-1. Put another way, an issuer must register as a broker-dealer with the state of Florida (the state has an issuer registration process) in order to complete a Regulation A or direct public offering, and sell securities to investors within the state of Florida. Tier 2 of Regulation A+ pre-empts state law and accordingly, Florida cannot impose issuer broker-dealer registration.

The sale of Securities in Florida is regulated by the Florida Office of Financial Regulation, Division of Securities and is generally found in Chapter 517 Florida Statutes and corresponding rules adopted under the Florida Administrative Code (F.A.C.), Chapter 517, Florida Statutes – Securities and Investor Protection Act and Chapter 69W-100 through 69W-1000, Florida Administrative Code.

All sales of securities in Florida must be made by a properly registered dealer (Chapter 517.12(1), Florida Statutes) or by someone utilizing an exemption provided by Chapter 517.12(3), Florida Statutes. However, the broker-dealer registration exemptions, including the issuer exemption, only apply to exempt offerings. Neither a Regulation A nor a direct public offering are exempt offerings. Accordingly, persons who sell securities in a Tier 1 Regulation A offering or direct public offerings, including issuers and their officers, directors and employees, must register as a broker-dealer in the state of Florida to sell to investors within the state of Florida.

In addition, Florida law has another trap where an issuer or finder could inadvertently violate the law. Florida Statute §475.41 specifically states that a contract by an unlicensed broker to sell or to negotiate the purchase or sale of a business for compensation is invalid and in particular:

No contract for a commission or compensation for any act or service enumerated in §475.01(3) is valid unless the broker or sales associate has complied with this chapter in regards to issuance and renewal of the license at the time the act or service was performed.

Fla. Stat. §475.01(3) defines "operating" as a broker as meaning "the commission of one or more acts described in this chapter as operating as a broker." "Broker" is defined broadly in Fla. Stat. §475.01(1)(a) and includes, among other things:

… a person who, for another, and for compensation or valuable consideration directly or indirectly paid or promised, expressly or impliedly, or with an intent to collect or receive compensation or valuable consideration therefore… sells… or negotiate[s] the sale, exchange, purchase, or rental of business enterprises or business opportunities… or who advertises or holds out to the public by any oral or printed solicitation or representation that she or he is engaged in the business of appraising, auctioning, buying, selling, exchanging, leasing or renting business enterprises or business opportunities… or who directs or assists in the procuring of prospects or negotiation or closing of any transaction which does, or is calculated to, result in a sale, exchange, or leasing thereof, and who receives, expects, or is promised any compensation or valuable consideration, directly or indirectly… (emphasis added)

Relying on these provisions, Florida courts and arbitration panels have found consulting and finder arrangements related to mergers and acquisitions and other corporate finance transactions that would otherwise not require federal broker-dealer registration, to be unlawful.

In addition to the conflict with federal law, the Florida statute is particularly troubling for practitioners as it is not included in the Florida Securities and Investor Protection Act found in chapter 517 of Florida Statutes. Florida Statute §517.12 is the state equivalent to Section 15(a)(1) of the Exchange Act requiring broker-dealer registration. Like the Exchange Act, §517.12 requires registration as a broker or dealer for the sale or offer of any securities.

Section 475, on the other hand, is the Florida statute governing "Real Estate Brokers, Sales Associates, Schools and Appraisers." Section 517 gives no reference to Section 475 and vice versa. Other than through research of case law, a practitioner would have no reason to research laws governing real estate transactions in association with business mergers and acquisitions and the payment of related finders' fees.

Selling securities without a license can be a criminal matter under §517.302. Violation of §517.302 is a third-degree felony, punishable by up to five years in prison and is a strict liability offense. A separate violation of §517.12 occurs every time the defendant sells a security without the proper license. Thus, a defendant who sells a security to eight different victims would commit eight separate violations of §517.12. Neither ignorance of the license requirement nor the defendant's good faith reliance on the advice of counsel is a recognized defense.

The Florida provisions remind us of the complexities associated with state blue sky compliance.

New York

New York State's securities statute, Articles 23-A of the General Business Law, known as the Martin Act, is unique among state securities laws in two important respects. First, the Martin Act does not require the registration of securities, other than securities sold in real estate offerings, theatrical syndications or intra-state offerings. Instead, it requires that issuers register as dealers in their own securities. New York exempts issuers from registering as dealers when they complete a firm commitment underwritten offering but not in other circumstances, including a best efforts underwritten offering or where no underwriter or placement agent is utilized.

Second, the Martin Act does not differentiate between registered or exempt offerings or provide for exemptions for federally covered (state pre-empted) offerings. The Martin Act requires that any person "engaged in the business of buying and selling securities from or to the public" to register as a broker-dealer. Although the Martin Act does not offer any guidance, case law has interpreted the words "to the public" to exclude private offerings under Section 4(a)(2). However, despite requests, New York has failed to amend the Martin Act to make any differentiation, leaving practitioners not knowing what, if any, notice filings would be required for private offerings.

As a result of the controversy surrounding New York's blue sky compliance, many practitioners simply do not file any notice documents or pay any fees where the offering pre-empts state law under the NSMIA. As a reminder, securities subject to the NSMIA are called "covered securities."

Covered securities may still be, and generally are, subject to notice filing requirements by the individual states. The NSMIA specifically allows the states to require a copy of any document filed with the SEC, together with annual or periodic reports of the value of securities sold or offered to be sold to persons located in the state (if not already included in the SEC filing) as long as such filing is solely for notice purposes and for the assessment or calculation of a fee. States may also require the filing of consent to service of process.

States may also require the payment of a fee in connection with a notice filing except that fees are specifically prohibited in connection with securities that are listed or authorized for listing on a national securities exchange such as the NYSE or NASDAQ and securities in Title III crowdfunding transactions except where 50% or greater of the securities are sold in a single state. Although a state may not condition the federal pre-emption granted by the NSMIA upon the payment of a fee, it can suspend an otherwise covered offering in its state for the failure to file a notice filing and pay the fee.

The Committee on Securities Regulation of the New York State Bar Association submitted a position paper to the Office of the New York State Attorney General in August 2002 related to New York's overreaching blue sky laws with respect to private offerings; however, the state of New York did not respond.

The Committee concluded that all offerings exempt under Section 4(a)(2) of the Securities Act and Rule 506 of Regulation D are exempt from the Martin Act and that New York cannot require issuers to register as broker-dealers for such federally pre-empted private offerings. The Committee goes further by stating that "[I]f New York State wishes to receive a notice and fee for Section 4(a)(2) and Rule 506 offerings, it must amend the Martin Act to require (or to permit the Attorney General to require) notice filings in non-public offerings." Many practitioners rely on this position paper in support of the position that no filings must be made with New York when relying on Section 4(a)(2) of the Securities Act.

Conclusion

My consistent view is that the SEC, together with FINRA, is best suited to govern most securities-related registrations and exemptions, including both for offerings and broker-dealer matters, and that the states should be more focused on state-specific registrations and exemptions (such as intrastate offerings) and investigation and enforcement with respect to fraud or deceit, or unlawful conduct.

I am thrilled with the opportunity that Tier 2 of Regulation A+ offers for issuers in completing going public transactions that pre-empt state blue sky law and would like to see an expansion of the NSMIA for direct and initial public offerings using form S-1.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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