

Practice Update

The Florida Crowdfunding Act - An Attempt to Facilitate Capital Raising by Small Businesses in Florida

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On June 18, 2015, Governor Scott signed CS/CS/CS/HB 275 (the ‘Florida Crowdfunding Act’), a copy of which can be found [here](#). The Act creates an exemption from state securities law regulation for certain intrastate crowdfunding transactions by Florida for-profit entities that satisfy the requirements of the Florida Crowdfunding Act. The Act will become law on October 1, 2015.

Background

“Crowdfunding” is the collection of small amounts of money from a large number of people to fund innovative projects, artistic endeavors, and non-profit political and charitable causes through the Internet. Over the past several years, Internet sites such as Kickstarter, GoFundMe, and IndieGoGo have allowed companies to “crowdfund” projects. Products such as games, books, movies, smart watches, 3D printers, and even a space telescope have all been crowdfunded online. However, crowdfunding to raise equity capital to fund small businesses has been prohibited because such transactions involve the sale of securities, which implicates the requirements of the Securities Act of 1933 (the ‘Securities Act’) and state securities laws.

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According to the U.S. Small Business Administration, the most common sources of capital to fund small businesses are owners' savings, family contributions, and external credit (such as bank or finance company loans, credit cards, or credit lines). However, many businesses - and particularly small businesses - cannot find the financing they need for their business. This issue has become particularly acute over the last few years. As a result, efforts have been made at the state and national level to find new and innovative methods to allow small business capital formation, while at the same time seeking to protect the interests of investors. The investor protection concerns include both the risk of fraudsters being involved in offerings, as well as the risks associated with the historic high rate of investor losses when investing in startup companies.

In April 2012, Congress adopted, and the President signed, the "Jumpstart Our Business Startups Act" (commonly called the JOBS Act) in an effort to ease regulatory burdens faced by startups and small businesses seeking to raise capital, especially for relatively small dollar amounts. Title III of the JOBS Act allows equity crowdfunding transactions under certain circumstances. However, the use of this provision is subject to rules to be adopted by the U.S. Securities & Exchange Commission (Commission). In October 2013, the Commission promulgated proposed rules designed to facilitate equity crowdfunding transactions. However, to date these rules have not yet been finalized. ([Click here](#) to view an Akerman Practice Update from November 2013 reporting on the Commission's proposed crowdfunding rules.)

Currently, the only legally authorized equity crowdfunding would be offerings that fall under the exemption from the Securities Act registration requirements that are contained in Rule 506(c) of Regulation D under the Securities Act. Regulation D allows sales of securities to "accredited investors" and permits general solicitation (which includes offerings through the Internet) under certain

circumstances. Since “accredited investors” are defined as natural persons with an individual net worth of more than \$1 million (not including the value of the investor’s primary residence) or income in excess of \$200,000 (\$300,000 with a spouse) in each of the two most recent fiscal years, this exemption is not particularly useful for many small businesses seeking capital that don’t have access to investors who qualify as “accredited investors.”

In the absence of Commission action to finalize equity crowdfunding rules under Title III of the JOBS Act, a number of states, believing that equity crowdfunding is an important element of future capital formation by small businesses in their state, have adopted legislation or regulations approving equity crowdfunding by businesses in their state. To date, 24 states, plus the District of Columbia, have adopted equity crowdfunding laws or regulations. All of these laws and regulations follow, in large part, the concepts for equity crowdfunding transactions that were contemplated by Title III of the JOBS Act and the Commission’s proposed equity crowdfunding regulations. A good source of information about the state of play with respect to intrastate equity crowdfunding around the country is the “Intrastate Crowdfunding Resource Center” maintained by the North American Securities Administrators Association, which can be found [here](#).

Overview of the Florida Crowdfunding Act

The Florida Crowdfunding Act creates a new equity intrastate crowdfunding exemption from state securities registration within the Florida Securities and Investor Protection Act (Chapter 517 of the Florida Statutes). The Florida Crowdfunding Act allows a Florida for-profit entity to raise up to \$1 million in a 12-month period, and to advertise their securities to the public over the Internet, provided that:

- Individual investments are limited to the greater of \$2,000 or 5% of the investor's annual income, if the individual's income or net worth is less than \$100,000, or 10% of the investor's annual income (not to exceed \$100,000), if the individual's income or net worth is greater than \$100,000
- The transaction qualifies for the intrastate exemption from registration provided under Section 3(a)(11) of the Securities Act
- The transaction is completed through an intermediary, as defined in the Florida Crowdfunding Act
- The funds are escrowed until the minimum amount disclosed as required for the project is raised
- Investors are given a three-day rescission right
- A form is filed with the Florida Office of Financial Regulation's Division of Securities (OFR)

Requirements for Issuers

To participate in intrastate crowdfunding in Florida, an issuer of securities to be sold in a crowdfunding transaction must be a Florida organized for-profit business entity registered with the Florida Department of State. The entity must maintain its principal place of business in Florida and derive its revenues primarily from operations in this state. Further, the exemption is not available for investment companies, blank check entities or entities that do not have a business plan or stated investment goals, or have plans to engage in a merger or acquisition with an unspecified entity, or have a class of securities registered under the Securities Exchange Act of 1934. Finally, the Florida Crowdfunding Act disqualifies companies that have officers, directors or more than 20% shareholders who are subject to a "bad actor" disqualification as set forth in §517.1611, Florida Statutes, and Rule 506(d) under the Securities Act.

Required Compliance with Section 3(a)(11) of the Securities Act

The Florida Crowdfunding Act requires equity crowdfunding transactions under the new act to comply with the “intrastate offering” exemption under the Securities Act. Section 3(a)(11) of the Securities Act creates an exemption from Securities Act registration for offers and sales of securities to persons resident in a single state where the issuer of the securities is also incorporated in and doing business within such state. Rule 147 under the Securities Act provides specific guidance on when offerings under §3(a)(11) will be deemed exempt from registration. These include requirements that 80% of the gross revenues of the issuer and its subsidiaries (on a consolidated basis) be derived from the subject state and, based on recent guidance from the Commission about §3(a)(11) and the Internet, requirements that the issuer and the intermediary have taken adequate measures, such as disclaimers, restrictive legends, and limited access to information, so that access to information about specific investment opportunities is limited to persons who confirm they are resident of the state by way of zip codes or address verification.

Based on this guidance, it will not be enough to simply post an ad on the Internet with a disclaimer that the offering is only available to residents in Florida. Further, issuers will generally not be able to use popular social media platforms (such as Facebook, Twitter, or LinkedIn) to promote their equity crowdfunding offerings, since these sites can be indiscriminately accessed by non-Florida residents.

The Equity Crowdfunding Process in Florida

Under the Florida Crowdfunding Act, the crowdfunding process in Florida begins with a company’s filing of a notice with the OFR, along with payment of a \$200 filing fee, at least ten days before the issuer commences an offering or the offering is

displayed on a website. This notice is immediately effective upon OFR's receipt of the notice, filing fee, and consent to service of process, expires twelve months after filing, and cannot be renewed. The notice contains information about the issuer and identifies the intermediary that will oversee the offering and the financial institution that will hold the investor funds in escrow until the "target amount" that the company is seeking to raise is obtained. The OFR may suspend a notice filing for material false statements and other deficiencies in the notice filing.

As with Title III of the JOBS Act, an issuer must execute an escrow agreement with a federally insured financial institution to hold investor funds, and must provide that escrow agreement to the OFR. The escrow agreement must provide that funds will be released to the issuer only when the capital received from investors has reached the pre-set target amount, and that otherwise, investors will receive a full refund of their investment commitment. Further, investors must be given the right to rescind their commitments to invest within three business days before the offering deadline.

Issuers must provide potential investors with a disclosure statement containing information such as a description of the business and its ownership structure, the target amount, and the price to the public of its securities. This disclosure statement must be filed with the OFR as well. The disclosure statement must also include certain financial disclosures and language the investor must accept to affirm their knowledge and understanding of the risks associated with the investment. Finally, the issuer must file with the OFR annual reports of their operations and financial statements within 45 days of the end of their fiscal year, including a management analysis of operations and compensation disclosure of certain persons. These reports must be filed until no crowdfunding securities are outstanding, must include any

material changes to disclosure statements, and must be provided to investors free of charge.

Further, unlike other exempt transactions under §517.061, the crowdfunding exemption is not self-executing, so crowdfunding issuers must demonstrate compliance with the requirements of the new exemption. Finally, the Florida Crowdfunding Act does not provide immunity from the antifraud or civil liability provisions of both federal and state securities laws.

Requirements for Intermediaries

Equity to be sold in crowdfunding transactions must be sold through intermediaries. Intermediaries are defined as either a registered broker dealer or a natural person or an entity registered with the Department of State to do business in Florida that registers with the state and facilitates the offer and sale of an issuer's securities under the crowdfunding exemption. Intermediaries are required to take measures to reduce the risk of fraud with respect to transactions, and to conduct certain due diligence requirements, including:

- Providing basic information to investors about the high risk of investment and the potential loss of all investment funds
Verifying that all potential investors are Florida residents
- Obtaining affidavits from investors that their investments do not violate the income rules and that they certify in writing the risks of investment
- Depositing and releasing funds pursuant to the escrow requirements, and refunding an investor's funds if an investment is canceled
- Providing monthly updates to investors after the offering's first month
- Taking reasonable steps to protect investors' personal information

- Prohibiting directors and officers of the intermediary from having a financial interest in the issuer
- Implementing written policies and procedures that are reasonably designed to achieve compliance with federal and state securities laws

Intermediaries, who may not be or include persons who are subject to a “bad actor” disqualification under the same definition of that term that applies to issuers, must register with OFR. Similar to registration of issuers, intermediaries are required to pay a \$200 filing fee, consent to process, consent to a state and federal background check of the intermediary and persons associated with the intermediary, and other requirements to be determined by OFR by regulation.

Intermediaries who are not registered broker dealers may not offer investment advice or recommendations, solicit purchases, sales or offers (or compensate others to solicit) to buy securities offered on its website, may not hold, manage, possess, or otherwise handle investor funds or securities, may not compensate third parties for providing leads to potential investors, and may not engage in any other activities set forth by rule by the OFR. The Florida Crowdfunding Act also subjects intermediaries to OFR examination and requires them to maintain certain books and records. It also subjects intermediaries to enforcement actions for certain violations of securities laws, rules and regulations where dealers, investment advisors, and associated persons would be subject to regulatory action by the OFR for violations of those laws, rules, and regulations.

The new act appropriates \$120,000 for the OFR to implement the provisions of this act, and the act cannot be used by Florida businesses to raise capital through intrastate crowdfunding transactions until the OFR has so acted.

Conclusion

The Florida Crowdfunding Act is an attempt by the Florida legislature to permit Florida businesses to raise capital through equity crowdfunding transactions. It has been hailed by many in the small business community as an important step towards capital formation by small business issuers in Florida. However, because the new act requires compliance with the “intrastate exemption” under Section 3(a)(11) of the Securities Act, requires issuers to comply with both disclosure, and escrow requirements and filings with OFR, and requires OFR to take certain actions before any intrastate crowdfunding transaction can occur in Florida (including licensing intermediaries to oversee equity crowdfunding transactions), it is hard to believe that there will be significant offerings using the new act for some time, if ever.

Further, if the Commission adopts final crowdfunding rules, such rules may supersede the new act in its entirety in light of the fact that Title III of the JOBS Act contemplates preemption of state regulation of equity crowdfunding transactions in most situations. In that regard, Commission Chair Mary Jo White recently announced that the Commission will consider for adoption final crowdfunding rules before October 31, 2015. While Chair White made a similar statement in 2014, it is the belief of the authors that the Commission will likely adopt final crowdfunding rules before the end of this year. If this occurs, such rules will likely become effective late in the year or early next year (90 days after the final rules are published in the Federal Register).

As a result, while the Florida Crowdfunding Act is unlikely to have significant relevance in facilitating equity crowdfunding transactions, at least in the near term, it continues the pressure by many in the business community to find creative ways to fund small businesses through innovative methods such as equity crowdfunding.

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