



## PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

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### **Via Electronic Submission: Stephen.Sandiford@hklaw.com**

Chairman Stephen Sandiford, Esq.  
Corporations, Securities & Financial Services Committee  
701 Brickell Ave, Suite 3300  
Miami, Florida 33131

### **Re: OFR Bill Reforming Chapter 517 - Recommendation to Support Florida's Office of Financial Regulation Ch. 517 Reform Legislation**

Dear Chairman Sandiford:

I write on behalf of the Public Investors Advocate Bar Association (“PIABA”), an international, not-for profit, voluntary bar association that consists of attorneys who represent investors in disputes with the securities industry. Since its formation in 1990, PIABA’s mission has been to promote the interests of the public investor by, among other things, seeking to protect such investors from falling prey to investment fraud, and advocating for public education related to investment fraud and industry misconduct. Our members and their clients have a fundamental interest in the rules promulgated by the Florida Office of Financial Regulations (the “OFR”) relating to exempt offerings, the practices of brokers and broker-dealers, and investor protection.

#### **I. Introduction**

On August 4, 2021, the Ch. 517 Task Force (the “Task Force”), primarily comprised of members of the Florida Bar’s Corporations, Securities & Financial Services Committee (“CSFS”), Business Law Fellows, and the OFR, approved the proposed Chapter 517 Reform Legislation (the “Proposed Legislation”) that materially impacts the Florida Securities and Investor Protection Act, “creates needed capital-raising opportunities for Florida-based businesses,” and “strengthens investor protection measures.” Contrary to the Task Force’s stated goal, it appears that the Task Force is more concerned with providing greater access to funds for exempt offering issuers than it is in providing necessary protections to public investors.

The Proposed Legislation should be narrowly tailored to address the capital formation needs of entrepreneurs and certain smaller issuers while preserving investor protections. Expanding exempt offerings in the manner proposed will do nothing to promote capital formation in the public markets, and will ultimately have negative consequences for investors. Additionally, the Proposed Legislation expands the pool of investors who may be

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eligible to invest in exempt offerings. The Proposed Legislation is solely focused on expanding the private markets that would unquestionably cause retail investors harm. The most likely outcome of the Proposed Legislation will be to increase private issuers, which will have the harmful effect of depriving investors in those companies of the benefits of registration.

## **II. Expansion of Exempt Offerings Will Undermine Investor Protection**

Expansion of exempt offerings to Florida retail investors will almost certainly increase the risks to which retail investors are exposed while decreasing the information available to investors attempting to make informed decisions about potential investments. It will also substantially increase the number of instances in which Florida investors fall prey to fraudulent investment schemes. These implications are significant and must be addressed if the Task Force is to honor its mission of protecting the investing public. If the Task Force is to expand the pool of investors who may be eligible to invest in exempt offerings, it must simultaneously improve investor protections for those who are eligible to invest.

The evidence is clear that fraud and other harms occur frequently where unregistered persons promote unregistered products to retail investors. In August 2020, the SEC's Division of Economic and Risk Analysis ("DERA") published a study of fraud in the private markets based on SEC enforcement actions brought over a single year.<sup>1</sup> Results from DERA's study showed that the majority of offerings were fraudulent offerings that did not qualify for an exemption from registration.<sup>2</sup> DERA's study further states that "offerings linked to SEC enforcement actions more likely involved an unregistered intermediary or a recidivist, or solicited from unsophisticated investors."<sup>3</sup> DERA study showed that while Florida had the sixth largest number of Regulation D issuers compared to all the other states, Florida had most number of issuers with unregistered offerings.<sup>4</sup> Florida also has the highest proportion of seniors in its population and accounts for the second largest number of seniors amongst all states.<sup>5</sup> With more than half of financial assets in the U.S. estimated to be owned by seniors,<sup>6</sup> elderly investors are considered to be the most targeted and vulnerable to financial exploitation.<sup>7</sup>

## **III. Finder's Exemption**

PIABA opposes the proposed registration of finders ("Finder's Exemption") for many of the same reasons PIABA opposed the U.S. Securities and Exchange Commission (the "SEC") Release Number 34-90112, Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders (the "Proposed Exemptive Order").<sup>8</sup> We strongly believe that if a finder acts as a broker with respect to the securities activities of non-reporting issuers, they should be subject to all of the requirements that would apply to a broker-dealer when acting in that same capacity.

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<sup>1</sup> Rachita Gullapalli, *Misconduct and Fraud in Unregistered Offerings: An Empirical Analysis of Select SEC Enforcement Actions*, SEC Division of Economic and Risk Analysis (Aug. 2020) ("DERA Study"), available at <https://www.sec.gov/files/Misconduct%20And%20Fraud%20In%20Unregistered%20Offerings.pdf>.

<sup>2</sup> *Id.* at 33.

<sup>3</sup> *Id.* at 11.

<sup>4</sup> *Id.* at 19.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> See Letter from PIABA President David P. Meyer to Vanessa Countryman, Re: File No. S7-13-20: <https://www.sec.gov/comments/s7-13-20/s71320-8011738-225383.pdf>.

Finders would not have to possess any minimum knowledge or competency with respect to securities to qualify for the exemption, nor would they have to pass any examinations or undergo any training or continuing education to serve as a finder. Because the exemption would allow virtually any individual to promote sales of unregistered securities so long as the individual was not statutorily disqualified, there would be no assurance to the investor, the issuer, or the securities market at large that such individuals have the knowledge, skills, integrity, or competency to serve investors or issuers in capital raising activities.

Finders would not need under the federal securities laws to notify regulatory authorities of their activities, or to keep any records of their activities, communications, or finances, making it extremely difficult for the Commission or any other regulator with jurisdiction over Finders to determine whether they were complying with the exemptive order or other applicable laws and standards. There would be no database, such as BrokerCheck, for investors to learn more about a Finder's background, including any customer complaints or past crimes or disciplinary actions that do not trigger disqualification.

The proposed exemption would not allow Finders to participate in the preparation of issuer sales materials, but in our experience, persons involved in securities sales are typically involved in the preparation of the sales materials that they will use to promote an offering. (It is not clear from the Proposal whether a Finder may provide investors with projections of the price performance of a privately offered security, which generally is not permissible for broker dealers.)

Because there would be no regular oversight of the use of these materials or standards applicable to such sales materials other than general anti-fraud laws, there remains a risk that Finders may be involved in preparing sales materials that are designed to maximize sales at the cost of compliance with standards requiring such communications to be fair and balanced.

Moreover, because Finders would not need to have any background in the securities industry or pass minimum knowledge or competency examinations, it is possible that Finders would not even recognize when they are providing misleading content to investors. The North American Securities Administrators Association ("NASAA") issues enforcement reports every year that summarize enforcement actions filed by state regulators. NASAA's recent Enforcement Report show that during 2019, state securities regulators brought 738 enforcement actions against unregistered persons, including against 57 unregistered finders or solicitors.<sup>9</sup>

In addition, Finders should be required to do their own due diligence before making a recommendation. Prohibiting Finders to investigate or perform reasonable diligence on an issuer or its securities may provide a shield from liability for a Finder in an investor's claim in arbitration that suffered losses from the Finder's solicitation activities. For example, a Finder could assert that the restriction from performing due diligence on the issuer, and thus any claims by an investor that the Finder should have known about any fraud or investment risk related to the investment would run counter to the Finder's obligations.

If the OFR does move forward with the Finder exemption, it should be limited only to natural persons because permitting entities to come into this space opens the door to boiler room operations and other fraudulent enterprises acting under the approval of an OFR exemption.

#### **IV. Crowdfunding**

The Task Force's reasoning to expand crowdfunding offerings is deeply flawed. As support for the proposed reform measures, the OFR states that "to date there has not been a single securities offering under Florida's

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<sup>9</sup> See NASAA 2020 Enforcement Report at 5, available at <https://www.nasaa.org/wp-content/uploads/2020/09/2020-Enforcement-Report-Based-on-2019-Data-FINAL.pdf>.

crowdfunding statute.”<sup>10</sup> As further support, the OFR states that “there have been numerous offerings in Georgia under their crowdfunding provisions that are substantially similar to the OFR’s reform proposals.”<sup>11</sup> Despite the Task Force’s assertions, Florida has had numerous crowdfunding offerings under its existing regulatory framework. In 2020, there were 1149 crowdfunding offerings in the U.S. that raised \$239 million.<sup>12</sup> Florida was among the top five states of those crowdfunding offerings for issuers, investments, and investors.<sup>13</sup> Moreover, Georgia was not among the leading states for crowdfunding offerings. Thus, mirroring Georgia’s crowdfunding provisions will not likely increase capital raising opportunities for smaller companies.

PIABA is also opposed to the growth of unregulated crowdfunded offerings. Our members often find that unsophisticated retail investors are the ones more likely to fall victims to fraudulent offerings. The OFR should not increase or waive the current annual cap on investors, accredited or not. More control and review will protect investors, therefore increasing offering document disclosure and auditing, as well as regulating or limiting promotion and advertising.

Additionally, the Task Force proposes to create a new exemption for micro-offerings under \$50,000. While a micro-offering could allow small business access to investors’ capital, businesses seeking relatively small amounts of capital should use traditional forms of financing, like commercial loans. The risk inherent in micro-offerings is not the type of risk that should be passed onto investors. Further, the ability of a business to issue a new micro-offering every thirty days would create a loophole for fraudsters to exploit, allowing them to raise larger amounts of capital than should be allowed under a micro-offering exemption.

PIABA members see cases where the investor is unaware of the liquidity or illiquidity of an investment which they are holding. In 2019, the SEC published the results of a study conducted by its staff on the capital formation and investor protection impacts of Regulation Crowdfunding (the “SEC Crowdfunding Report”).<sup>14</sup> According the SEC Crowdfunding Report, the average issuer had “no revenues (just over half of the offerings were by issuers with no revenues).”<sup>15</sup>

Florida entities that have conducted 4(a)(6) offerings have done so under funding portals registered with the SEC and FINRA. The following make up a small sampling of the crowdfunding offerings conducted by Florida entities, with the exception of one foreign entity with its principle place of business in Florida.

- Acquire Skills & Knowledge Education Inc. (“ASK Education”), Boca Raton, FL: Target raise \$10,000 to \$107,000, and crowdfund offering closes on November 2021.<sup>16</sup>
- Jinglz, Inc., Boynton Beach, FL: Funds raised to date \$248,588.00, crowdfund offering closed on April 2021.<sup>17</sup>
- We Are Kula, LLC, Boca Raton, FL: Total funds raised \$12,479.00, and crowdfund offering closed on September 2020<sup>18</sup>

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<sup>10</sup> See Ch. 517 Task Force Report at p. 3.

<sup>11</sup> *Id.*

<sup>12</sup> See Alois, JD, *\$239 Million was Raised using Reg CF During 2020, this Amount Could Double in 2021*, Crowdfund Insider (Jan. 6, 2021), available at <https://www.crowdfundinsider.com/2021/01/170982-239-million-was-raised-using-reg-cf-during-2020-amount-could-double-in-2021/> (citing a report by Crowdfund Capital Advisors (“CCA”).

<sup>13</sup> *Id.*

<sup>14</sup> See SEC 2019 Regulation Crowdfunding Report (Jan. 18, 2019), available at <https://www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding/2019Report>.

<sup>15</sup> *Id.* at 17.

<sup>16</sup> See Netcapital fund portal, available at <https://netcapital.com/companies/ask>

<sup>17</sup> See Netcapital fund portal, available at <https://netcapital.com/companies/jinglz>

<sup>18</sup> See Netcapital fund portal, available at <https://netcapital.com/companies/kula-crate>

- Janover Ventures LLC, Boca Raton, FL: Total funds raised \$714,052.00, and crowdfund offering closed on December 2020.<sup>19</sup>
- Northstar Technologies Group, Inc., Bonita Springs, FL: Funds raised to date \$400,368.00, and crowdfund offering closing date is November 1, 2021<sup>20</sup>
- Stemsation International, Inc., Boca Raton, FL: Total funds raised \$ 43,248.00, and crowdfund offering closed on March 2020.<sup>21</sup>
- Atmospheric Water Solutions, LLC (“AquaBoy”) Cooper City, FL: Funds raised \$194,245.00, and crowdfund offering closed on April 2021.<sup>22</sup>
- COI Energy Services, Inc. (Incorporated in Delaware), Tampa, FL: Total funds raised \$589,026.00, and crowdfund offering closed on April 2021.<sup>23</sup>
- Domaselo, LLC, Key Biscayne, FL: Total funds raised \$57,500.00, and crowdfund offering closed on January 2021.<sup>24</sup>

## V. Conclusion

Once again, PIABA appreciates the opportunity to comment on the Task Force’s Proposed Legislation. We urge the OFR to remember its mission to protect investors while it tackles the legitimate goal of simplifying the exempt offering framework. Although increasing the efficiency of the capital markets and ability of companies to raise money is a laudable goal, it cannot be done at the detriment of Florida investors.

PIABA would be happy to engage with the OFR further on this issue.

Respectfully submitted,



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<sup>19</sup> See Republic fund portal, available at <https://republic.co/janover-ventures>  
<sup>20</sup> See Netcapital fund portal, available at <https://netcapital.com/companies/northstar-tgi>  
<sup>21</sup> See Netcapital fund portal, available at <https://netcapital.com/companies/stemsation>  
<sup>22</sup> See Netcapital fund portal, available at <https://netcapital.com/companies/aquaboy>  
<sup>23</sup> See Republic fund portal, available at <https://republic.co/coi-energy>  
<sup>24</sup> See Mainvest fund portal, available at <https://mainvest.com/b/domaselo-miami#updates>