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COMMITTEE ON COMMERCE

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John R. Forbes
Chairman
John W. Lewis
Vice Chairman

May 9, 1978

STAFF REPORT

HB 2118

PCB 39 (Third Revised Draft) -- Chapter 517 --
The Florida Securities Act;

BACKGROUND

The attached bill is a substantial reworking of the existing Florida Securities Law. It is being presented to the Committee by the Division of Securities of the Department of Banking and Finance. The 1978 session is the 3rd session in which a bill to substantially rework Chapter 517 has been submitted.

In previous years different bills have been considered by the House Commerce Committee. In 1975, the Florida Law Revision Council sponsored a complete revision of Chapter 517 which reflected the full disclosure view of Securities Regulation. Comptroller Lewis and his staff opposed this bill due to the absence of what Comptroller Lewis characterized as "upfront consumer protection"; i.e., merit review of securities. The Council's bill passed the House, but failed in the Senate.

In 1976, Representative Steinberg sponsored the Law Revision Council's revision of Chapter 517 and the Comptroller came forth with his revision of Chapter 517 which updated the existing law but retained totally the merit review philosophy of Securities Regulation. Neither bill was successful.

The Division of Securities, the Security Dealers Association and the Bar have attempted to achieve a compromise position for nearly three years. The Division has informed committee staff that PCB #39 is that compromise.

78-435

HB 2118

SB _____

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Sponsor(s) Commerce, Steinberg

Effective Date: November 1, 1978, except Section 9 shall take effect July 1, 1978

BRIEF:

House Bill 2118 is the major revision of the securities law that has been in preparation for three years. The major debate has been between the law revision council position which is based on full disclosure and the Comptroller's position which is based on initial review and prior approval requirements.

The bill basically supports the Comptroller's position and the present law requiring review and prior approval rather than relying solely on full disclosure. The important differences from the existing law are outlined in the attached May 9 staff memo.

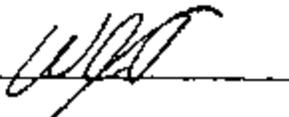
The major difference is the addition of an exemption for securities undergoing registration procedures pursuant to the Federal Securities Act (Section 517.061(17), page 17 of the bill). In addition, the Comptroller's authority to ask for restitution, issue cease and desist orders and use other means of relief are improved. The bill also creates a "guaranty fund" against which victims of securities violations may claim for individual damages (Section 5 of the bill beginning on page 31). This fund is created by a \$25 per year fee from dealers and a \$5 fee from salesmen with a cap on damages which can be claimed.

The bill also exempts from the "Investor Protection Act" (the Anti-tender Offer Act) a purchase of a large block of stock from fewer than 15 persons of a public corporation held by a least 500 persons. It also changes the Statute of Limitations from an absolute 4 years to 2 years from the discovery of the facts involving a violation of the Securities Act. (Section 11, page 19)

Mr. Noel Nation, Chairman, Corporations, Banking and Business Law Section, Florida Bar, indicated that they generally support the legislation even though there are some particular technicalities in Florida's bill as it relates to the federal law. These technicalities can be handled next year.

RECOMMENDED ACTION:

- 1. Sign into Law without ceremony X
- 2. Sign into Law with ceremony
- 3. Law without Governor's signature
- 4. Veto

STAFF Jim Tait 



FLORIDA HOUSE OF REPRESENTATIVES

DONALD L. TUCKER, Speaker/JOHN L. RYALS, Speaker Pro Tempore
COMMITTEE ON COMMERCE

May 9, 1978

John R. Forbes
Chairman

John W. Lewis
Vice Chairman

STAFF REPORT PCB#39
(Third Revised Draft to reflect the
bill as passed by full committee)

The following section by section comments were prepared by Donald A. Rett, former Director of the Division of Securities, under the direction of the Division of Securities with the assistance of committee staff.



FLORIDA HOUSE OF REPRESENTATIVES

DONALD L. TUCKER, Speaker/JOHN L. RYALS, Speaker Pro Tempore
COMMITTEE ON COMMERCE

John R. Forbes
Chairman

June 14, 1978

John W. Lewis
Vice Chairman

ADDENDUM TO STAFF REPORT

HB 2118 -- securities (as passed)

As a result of amendments adopted on the floor of the House (see HJ p. 782), the last three lines of page 17 should be disregarded. Section 517.303, as adopted, eliminates the former requirement that original documents be retained by the department for 10 years. Those documents may now be destroyed after an audit has been performed, the documents have been reproduced on microfilm, and the requirements of the public records law have been met.

RNJ/jc

PROPOSED COMMITTEE BILL 39
CHAPTER 517 REVISION
SECTION BY SECTION COMMENTS

The contemplated legislation for Chapter 517 will follow the existing structure as it relates to registration of securities; registration of dealers, salesmen, investment advisers, and issuers; exemptions; and prohibited practices. However, each of these respective areas has been substantially modified in order to keep pace with a rapidly expanding industry. The new Act places substantial emphasis on enforcement of the law, while expediting registration procedures which often are time consuming and costly to the industry.

State decisions on any provisions which are repealed or amended are controlling when interpreting the new sections unless the prior decisions are in direct conflict with the new provisions. Federal decisions are merely persuasive unless adopted by a state decision. See Merrill Lynch, Pierce, Fenner, and Smith v. Byrne, 320 So.2d 436 (Fla. Dist. Ct. Appl. 1975). Decisions of sister states with identical or similar provisions should be treated as the federal decisions and thus are merely persuasive. These interpretative guidelines should be followed whenever a question arises as to the meaning of any section within the Act. The specific section comments should be used in conjunction with the aforementioned interpretive guidelines. The comments deal directly with the intent of the specific statutory section.

Section 1

Section 517.011; formerly Section 517.01, Florida Statutes; Part I of Chapter 517 is renamed the "Florida Securities Act" as opposed to the "Sale of Securities Law."

Section 517.021, formerly Section 517.02, Florida Statutes. The definitional section has been expanded to define "affiliate," "associated person," "control," "underwriter," and "securities option." The terms "agent," "broker," "department," "person," "salesman," and "security" remain essentially the same as defined in Section 517.02, Florida Statutes. The terms "dealer," "investment adviser," "issuer," and "sale" or "sell" have been substantially modified. The most important distinction is the clarification between "dealer" and "investment adviser." This distinction was not recognized under the prior law. A "dealer" is actively engaged in selling securities while an "investment adviser" provides advice concerning securities and is not involved in the actual sale of securities. "Issuer" has been separately defined to eliminate the problem of an "issuer" being defined as "dealer" which existed under the prior law. The terms "sale" or "sell" relate to the disposition of a security. The terms "offer to sell," "offer for sale," and "offer" relate to the attempt to dispose of securities. This distinction is embodied in subsequent sections of the Act pertaining to exemptions, registration of securities, dealers, salesmen, investment advisers, and prohibited prac-

tices or acts. This should not be construed to limit or restrict the department from enforcing the provisions of the Act, but should be followed strictly between parties to a private action or in a criminal prosecution. The definitional section is only applicable to Part I of the Act and is controlling when rules are promulgated which use these terms.

Section 517.031, Florida Statutes, is repealed. The section mandated certain notice requirements when rules are promulgated by the department. This section has been superceded by Chapter 120, Administrative Procedures Act, which is controlling as to notice requirements when rules are promulgated.

Section 517.041, formerly Section 517.04, Florida Statutes: Sections (1) and (4), which relate to the employment of additional help and the annual report to the Governor, have been retained.

Existing Section 517.05, Florida Statutes, "Exempt Securities," will be renumbered 517.051 and changed as follows:

1. Subsection 517.051(4) remains essentially the same as the existing provision, 517.05(4).

2. The "...initial subscription for equity securities..." of any Florida bank, trust company, or savings institution will become exempt securities under the proposed bill. (They are not currently exempted by Section 517.05(8), F. S.) However, proposed 517.051(5) will require a filing of a notice of intent to raise such equity prior to the exemption being available. In addition, the securities of a foreign bank, trust company, or savings institution would also be exempt if the entity is subject to the examination, supervision, and control of this state. This provision would thus be applicable to institutions in 659.67, International Banking Corporations and Agencies.

3. The proposal deletes from "exempt securities" status those securities trading on the New York Stock Exchange and other exchanges, as well as all securities senior in ranking to those trading on the exchanges. (See ss. 517.05(6) and 517.05(7), F. S.) However, the sale of such securities would be exempted as an "exempt transaction" when made by a dealer registered pursuant to s. 517.12, if proposed s. 517.061(18)(a) is adopted.

4. A substantial change is proposed to existing section 517.05(5), F. S. As currently written, the law requires that an offeree receive no more than

"...a written report as to the feasibility of the project and the full disclosure of the method of financing." The proposal would amplify the minimum disclosure an offeree must receive. (See proposed 517.051(8).)

Existing Section 517.06, F. S., "Exempt Transactions," will be renumbered 517.061 and changed as follows:

1. Additional wording has been inserted in proposed Section 517.061(1), F. S., which will allow the issuance of securities without registration when done pursuant to a "...judicially approved reorganization..." This will correct the situation where a civil court orders certain changes made in the securities structure of a corporation; under the existing law, these transactions are not exempted even though a court has passed upon the fairness of the reorganization.

2. A structural (only) change has been made to existing section 517.06(4), F. S. The three exemptions currently found there have been split into three separate exemptions, and renumbered (proposed) ss. 517.061(4), (5), and (6).

3. The provisions of existing sections 517.06(5), F. S., and 517.06(17), F. S., have been combined with certain changes (517.061(7)):

a. The sale of securities to a corporation would no longer be exempt;

b. A threshold dollar amount is inserted for the asset value (\$500,000) of a pension or profit sharing plan before sales to them would be exempt.

4. The registration exemptions in existing ss. 517.06(7) and 517.06(8), F. S., have been deleted. These subsections were responsible for the "14% racket," the land-securities fraud investigated by the 1976 House Select Committee on Mortgage Frauds. Amendments to Chapter 494 (The Mortgage Brokerage Act) and Chapter 478 (Florida Uniform Land Sales Practices Law) have effectively eliminated the mortgage fraud which existed with the "14% racket."

As substitute therefor, P.C.B. 39 would exempt from registration the issuance of notes or bonds in connection with the acquisition of real property, so long as such notes or bonds are issued to the sellers of--and secured by--all or part of the real property so acquired.

5. The "small offering" or "private placement" offering (proposed 517.06(11)) has been enlarged upon, both as to the number of purchasers and the disclosure requirements necessary. The distinction between pre-incorporation (existing 517.06(10), F. S.) and post-incorporation (existing 517.06(11), F. S.) has been eliminated. P.C.B. 39 would accomplish the following:

a. Permit unregistered sales during any consecutive twelve-month period to not more than thirty-five persons (up from 20/25 in the current law). This

number agrees with the federal exemption for registration;

b. Mandate the distribution of an offering circular containing material financial information, unless sales were made to five or fewer persons;

c. Prohibit public advertisement of the offer;

d. Prohibit the payment of a commission in connection with the sale unless the recipient was a registered securities dealer;

e. Exclude from the computation of purchasers those individuals wishing to invest \$100,000 or more;

f. Establish an escrow arrangement for the deposit of funds where more than five purchasers are involved. The proceeds from the securities sales would be escrowed pending the completion of the offering--or returned to the investors if the venture did not raise sufficient capital;

g. Institute a three-day cancellation period during which time an investor can void his purchase.

6. An entirely new category of exempt transactions is added by P.C.B. 39. Under section 517.061(17), the sale of securities pursuant to a registration statement effective under the Federal Securities Act of 1933 would be treated as an exempt transaction, so long as:

a. Certain filings are made with the department for notice purposes only;

b. A fee of .1% of the aggregate sales price is paid to the department (computed on the securities to

be sold in Florida; minimum, \$20; maximum, \$750.)

7. P.C.B. 39 eliminates the registration exemption for the sale of securities by an employer to an employees stock option plan or stock purchase plan intended to qualify with ss. 422, 423, or 424 of the Internal Revenue Code.

ction 2

Summary - This section makes only one substantive change in the existing law (517.07, F. S.): A registration permit will be valid for not more than one year from the date it was granted. The current law specifies no time frame, but the department has consistently applied a one-year standard.

ction 3

Summary - This section repeals six sections of the existing statute, retaining certain functions in a consolidated form:

1. Existing Section 517.08, F. S., is repealed as no longer necessary if P.C.B. 39 is adopted. Under the existing law, a "mini-registration" is available to issuers who register concurrently with the Federal Securities and Exchange Commission and the Division of Securities. Proposed Section 517.061(17) of this bill would render exempt sales of securities registered with the S. E. C., hence 517.08, F. S., is repealed.

2. Existing Section 517.09, F. S., is retained with substantially the same text, and renumbered 517.081.

This section sets the qualifications necessary for an issue of securities to be registered and sold in Florida.

3. Section 517.0901 is repealed. This section of the existing law permits an appeal to the State Board of Administration in the case of agency denial of an application filed pursuant to ss. 517.08 or 517.09, F.S. This appellate review has been obviated by Chapter 120, F.S., the Administrative Procedures Act.

4. Section 517.091, F.S., "Registration by Announcement" is repealed. This procedure is rarely utilized, and it will be supplanted by proposed section 517.081.

5. Section 517.10, F.S., "Consent to Service," will be retained in substantially the same form by the proposed bill and renumbered as 517.101.

This section requires that a securities issuer not domiciled in Florida execute a consent to service of process prior to its application becoming effective.

6. Section 517.111, sets forth the grounds upon which the department may revoke an effective securities registration. The proposal would allow the department the explicit authority to deny registration (on the same grounds) to an application which has not yet become effective. In addition certain grounds on which a security could have been been revoked or denied under existing law (such as whether the issuer was of bad business repute or conducts his business in an unsound manner) are deleted as unworkable and possibly unconstitutional.

Section 4

Summary - This section deals with the registration of those individuals or firms which sell securities--broker/dealers and securities salesmen--and those who render investment advice. The proposed section replaces existing 517.12, F. S., and departs therefrom in the following manner:

1. Currently, all the "issuers" (defined at existing 517.02(5), F. S., and not changed by this bill) of exempt securities (517.05, F. S.) escape registration as broker/dealers so long as they are only selling their own securities. For instance, U. S. Government Bonds are exempt securities, and the U. S. Government can sell those securities without broker/dealer registration. The P.C.B. would alter that treatment, but only to the extent that sales of securities exempted from registration by proposed 517.061(19) would have to be made by a registered broker/dealer.

Proposed 517.061(19) is a new provision in Florida's Securities Act, exempting for the first time those securities being registered under the Federal Securities Act of 1933. However, the bill would require registration of those broker/dealers selling such securities, as is the case under existing Chapter 517, F. S.

3. A statutory requirement is added to require the submission of fingerprint cards to the Florida Department of Criminal Law Enforcement or the Federal Bureau of Investigation.

The current law (517.12(10), F. S.) requires applicants

to submit such fingerprints, but does not mandate further processing. Hence, the department is unable to have the cards processed by either the state or federal criminal authorities.

4. Under the existing statute (517.12(2), F. S.), the department may require individual applicants to pass an examination prior to being licensed as broker/dealers, securities salesmen, or investment advisers. The bill proposes an exemption from the Florida examination for those applicants who have passed "...the test required in Sec. 15(b)(7) of the (Federal) Securities Exchange Act of 1934."

Section 5

Summary - This section will make material changes in the securities law. Among them are:

1. The deletion of a mandatory bond for a securities dealer to be licensed in Florida and the substitution therefor of a "Guaranty Fund" against which victims of securities violations may claim;
2. An updating of the department's powers when investigating violations of the Act;
3. In any court proceedings brought by the department, the department will have the power to ask the judge hearing the matter to issue an order of restitution (or disgorgement). If the judge, in his discretion, decides that restitution is proper, the defendants will be forced to repay those victims whose funds were taken in violation of the law;

4. The section will add a Cease-and-Desist provision whereby the department may issue an order to any person it finds violating or about to violate the securities act. The department will gain the authority to impose an administrative fine (\$1,000 maximum) against any violation of a cease and desist order;

Section 517.131 (Proposed): Section 5 of the P.C.B. would repeal seventeen existing sections of Chapter 517, three of which have to do with the bonding of individuals registered to be broker/dealers or investment advisers (517.13, .14, .15, F.S.) P.C.B. 39 would eliminate entirely any bonding requirements for such registrants, substituting therefor, a "Security Guaranty Fund" to be funded through an assessment imposed upon them. The cost to a dealer would be \$25 per year and for each salesman, \$5 per year. The bill proposes a "cap" of \$250,000 on the Fund, with a "floor" of \$150,000. The Department projects that, in the absence of any claims, the fund will reach its "cap" within three years.

Section 517.141 (Proposed): Disbursement from the Fund would be made to any person who suffers monetary damages as a result of some violation by a registrant of the proposed bill. First, however, the victim must reduce his claim to judgment, and attempt to collect thereon. A person can collect no more than \$10,000 from the Fund, and in the case of multiple claims

against one registrant, a cap of \$100,000 is set. Claims in excess of that amount would be prorated.

Section 517.151 (Proposed): This section recites the investments authority delegated to the treasurer of the state.

Section 517.161 (Proposed): There are no material differences between this proposed section and the existing section (517.16, F.S.) it replaces. This section outlines the substantive reasons the department may utilize to deny an application--or to revoke an existing permit-- for a broker/dealer, securities salesman, or investment adviser. A claim by the department under this section can be used as a basis for adverse administrative action against the registrant.

Section 517.171: There is no difference between this proposed section and the existing section (517.17, F.S.) it replaces. The section places a burden for perfecting a registration exemption upon the person gaining the benefit therefrom.

Section 517.181 (Proposed): There is no material change between this proposed section and the existing section (517.13, F.S.) it replaces. This section gives the department the discretion to require an escrow of securities when it is proposed to issue same

Section 517.191 (Proposed): Subsection (3) contains the only material change between the existing law (517.19, F. S.) and the proposal. This section gives the department power to investigate activities which the department believes to be violative of the Act. When it discovers evidence of a violation it may apply to a civil court for injunctive relief.

Proposed subsection (3) would permit the department to request the trial judge to order the defendant(s) to make restitution to the victims of their violations. The trial judge would have the discretion to enter the order or not. This last subsection would, if passed, represent a departure from established case law. In 1974, the Third District Court of Appeal, in discussing Section 517.19, F. S., said:

"Nothing in the statute authorizes the state to seek recovery on behalf of private purchasers. The wisdom of this decision of the Legislature is evident since the private purchasers are not parties in this suit and therefore, have not been heard upon the business decision involved."

Wee Mac Corporation v. State Ex Rel Dickinson,

Fla. App. 301 So.2d 101.

This decision has been followed by other Florida courts, thereby thwarting the department's efforts in obtaining disgorgement and forcing the victims to initiate litigation themselves. Meanwhile, at the federal level, the Securities and Exchange Commission has had a good deal of success in its disgorgement cases. See, for instance, S.E.C. v. Manor Nursing Centers, 458 F.2d 1082 (2d Cir. 1972).

Section 517.201 (Proposed): The only material difference between this proposed section and the one (517.20, F. S.) in existing law is found in proposed subsection (6).

This section gives the department power to subpoena those persons and evidence which the department believes necessary to an investigation. Under (proposed) subsection (6), the department would not have to make publicly available that "...material compiled by the department in an investigation under this Act...." This statutory cloaking of investigative material is not provided for in the current law.

Section 517.211 (Proposed): There are two substantive changes in this proposed section:

1. A victim of a securities act violation would be allowed to recover whatever damages he has suffered, and not be restricted to a six percent return on non-interest bearing securities (see existing 517.21(1)(b), F. S.). For instance, under the existing statute a violator could purchase securities for \$10,000 knowing they were worth \$50,000, but failing to reveal the higher value to the seller. The purchaser then sells the securities for \$50,000. In a subsequent civil action the original seller would have a difficult time collecting any more than \$10,000--plus interest--from the violator. This is because of the current statutory language, which the proposed section will rectify by allowing a victim to sue for "damages."

2. The current statutory language allows a plaintiff to recover attorneys fees, but it is not clear that such fees can be recovered if he must appeal to a higher court. By adding the words "...including appeals..." this shortcoming is corrected.

Section 517.221 (Proposed): This section has no counterpart in the existing statute, although the department currently possesses the remedy (cease and desist orders) by Rule (3E-10.08, F. A. C.). If this section is adopted, the department will be able to statutorily issue a restraining order against the defendant without going to court. The defendant will have rights to a hearing before the Division of Administrative Hearings. The section will also allow the department to assess an administrative

fine (not to exceed \$1,000) if the defendant is found to have violated a cease and desist order.

Section 517.241 (Proposed): This section re-codifies existing sections of Chapter 517, F. S., as follows:

1. Section (1) incorporates and modernizes existing section 517.24;
2. Section (2) incorporates existing section 517.22;
3. Section (3) incorporates existing section 517.23;
4. Section (4) incorporates existing section 517.25.

Section 6

Summary - This section makes nominal substantive changes to the existing law.

Section 517.301: A "cosmetic" change is made here, in that the term "inconnection with the purchase or sale of any security" is relocated to the introductory language. This is for purposes of clarification only, and does not otherwise alter existing law.

Subsections (2) and (3) of this proposal are not changed from existing sections 517.301(2) and 517.301(3), F. S.

Section 7

Summary - This section makes a nominal change in the department's recordkeeping requirements and maintains funding of the department through the General Revenue Fund.

Section 517.303 (Proposed): This section would shorten to five years (from ten) the period of time the department must retain original documents (see existing 517.33, F. S.)

Section 517.304 (Proposed): This section would retain the funding method for the Division of Securities as currently found at 517.04(3), F. S.

Section 8

Summary - This section only makes technical, numbering changes to existing section 517.311.

Section 9

Summary - This section would add an exemption from the requirements of the "Investor Protection Act," (Chapter 77-441, Laws of Florida.

Under that law (commonly called the "Corporate Takeover Act") a person seeking to acquire more than 10% of the equity in certain Florida corporations must offer "...substantially the same terms..." to all shareholders. However, the law contains certain "exemptions" whereby that mandate need not be followed. One exemption which is not included, however, is the often-encountered situation where a person who owns a large block of the company's stock seeks to sell it. It is common financial practice for a prospective purchaser to offer a premium for such a block of equity, since the purchaser is relieved of the necessity of assembling many tiny blocks of stock in order to buy the quantity sought. There is no provision for this premium in the existing law. If the transaction (when completed) would see the purchaser owning more than 10% he must--as noted above--go through a tendering process.

to all shareholders.

Therefore, section 9 proposes adding a sixth "exempt offer" to the five currently found at Section 517.351(5), F. S. The proposal would exempt as not being a "tender offer" the offer to acquire equity securities from 15 or fewer offerees within 12 consecutive months. The exempt offer would also require that there be no public solicitation or advertising by the offeror when making the offer.

Section 10

Summary - This section, if adopted, will add a severability clause to Chapter 517. Thereafter, if any provision of the Act is found to be invalid, then the affected provision can be eliminated without jeopardizing the vitality of the law (Proposed Section 517.364.)

Section 11

Summary - This section will add a provision to Chapter 95, F. S., dealing exclusively with Chapter 517, F. S. Under the proposal a person who feels that a violation of the Securities Act has been perpetrated on him will have two years from the discovery of the facts (or from the time they should have been discovered) to rectify the matter. Currently, a person has four years to rescind a contract; but if the person has no opportunity to discover the facts during that period, he is barred by Section 95.11(3)(1), F. S., from enforcing his claim.

Section 12

Summary - This section is added in order to resolve an inconsistency between Section 517.302, F.S., and Section 775.15(2)(b), F.S.

The former section provides a "...statute of limitations for prosecution of offenses committed under this Part (which) shall be 5 years." However, the latter section restricts the "...prosecution for any other felony (to) 3 years after it is committed."

The Department feels that the longer period of time is necessary in order to have effective enforcement of the securities law. Hence, it is proposing a five-year statute of limitations.

Section 13

Summary - Provides an effective date of November 1, 1978 except for Section 9 which becomes effective on July 1, 1978.