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Issuer-Dealer and Agent Registration Requirements for Issuers Not Utilizing a Registered Broker-Dealer for Offers and Sales of Securities under Tier 2 of Regulation A

Regulation A of the Securities Act of 1933 adopted by the Securities and Exchange Commission ("SEC") provides early-stage companies with greater access to capital through the ability to raise up to $75 million, but also a greater ability to communicate with investors through novel communication rules previously unavailable to issuers in a public offering of securities. Whereas previously, communications for public offerings were limited to the information contained in an offering prospectus or offering circular, the amendments to Regulation A instead allow issuers to freely communicate before any filing or qualification with the SEC under the Testing the Waters provision (Rule 255), and after qualification (Rule 251(d)(iii)).

These communication rules can help companies go it alone, so to speak, without the assistance of a registered broker-dealer. In a traditional offering, a broker-dealer acts as an intermediary bringing investors to the issuer for a fee. For a company seeking investors among the general population, a broker-dealer may not be necessary to have a successful Regulation A offering. Issuers are able to publish their own marketing material about the offering, create their own online campaign pages, and generally solicit their targeted investor base. This may be especially relevant for consumer-facing companies interested in engaging customer-investors.

However, companies issuing securities in a public offering without the involvement of a registered broker-dealer should be aware that the company may be required to register in certain states as an issuer-dealer, or have members of its management team register as agents of the issuer. This memorandum provides an overview of the registration requirements for issuers and agents of the issuer when making offers and sales of securities in specific states that require such registration. This memorandum will focus on offerings under Tier 2 of Regulation A, as Tier 2 provides for preemption of state review of the offering and securities sold under a Tier 2 offering are considered "covered securities" under Section 18 of the Securities Act.

What does preemption get you?

As part of its rulemaking, the SEC defined securities offered and sold under Tier 2 of Regulation A as "covered securities". Under Section 18 of the Securities Act, covered securities are exempted from state review of the offering through the exercise of federal preemption of state authority on matters of interstate commerce. Specifically, Section 18 provides that, for covered securities, any state is prohibited from "requiring … registration or qualification of securities, or registration or qualification of

securities transactions…". As a result, a state may not deny an issuer the ability to offer or sell a security in the state that is seeking qualification, or has been qualified by the SEC under Tier 2 of Regulation A.

However, this exemption is limited to the registration requirements for the offering of the securities. It does not impact the registration requirements for intermediaries in an offering or whether issuers are required to register themselves as dealers, should they decide to not utilize a registered broker-dealer in the offering. As a result, companies may find it advantageous to work with a broker-dealer merely to avoid the issuer-dealer registration requirements of the states that have such requirements.

Nevertheless, many issuers still may decide that moving forward without a broker-dealer is in their best interest, even with the issuer-dealer registration requirements. As of October 2021, it appears that Florida, New York, and Texas all require issuers to register as dealers in the state if they are not using a registered broker-dealer in an offering of securities under Tier 2 of Regulation A. Nebraska, Arizona, and North Dakota used to be included in this list, but recent changes to state law have created an exception to the state issuer-dealer registration requirement when pursuing an offering under Tier 2 of Regulation A so long as no commission or other remuneration is paid for soliciting investors. Additionally, Alabama, Nevada, New Jersey and Washington each require an agent of the issuer to register with the state.

State review of notice filings

A topic related to preemption, but not necessarily related to issuer-dealer registration, is state review following delivery of notice filings. States may require notice filings and filing fees related to any offering of a covered security. They may also pursue enforcement under any anti-fraud authority contained in their securities laws. We have noticed that as part of the notice filing process, certain states have questioned the broker-dealer status of online investment platforms (even when a registered broker is involved in the offering), and have raised questions regarding the content of the offering circular in a manner that would seem to approach substantive review, as discussed in our blog post here.

Documents used to register with each state

While a few states have created their own forms, most states have adopted uniform forms created by the North American Securities Administrators Association ("NASAA"), the SEC, or by the Financial Industry Regulatory Authority ("FINRA"). The commonly used forms include:

Form BD – Uniform Application for Broker-Dealer Registration

Form U-2 – Uniform Consent to Service of Process

Form U4 – Uniform Application for Securities Industry Registration or Transfer

It should be noted that as part of submitting a completed Form U4 in certain states, any agent or salesperson identified in the form must submit fingerprints to the state regulator.

States that require issuer-dealer registration

The first thing that may stand out to you is that there are not that many states that require issuer-dealer or agent registration. This is due to the fact that most state securities laws exclude issuers from the definition of brokers or dealers that need to be registered, as well as excluding officers and directors of the issuer as "agents" requiring registration.

Many states have adopted some form of the 2002 Uniform Securities Act (the "USA"). In section 102(4)(B) of the USA, issuers are exempted from the definition of a broker-dealer. Additionally, under Section 102(2), officer and directors of the issuer are deemed not to be agents unless they otherwise qualify for agent registration. The USA clarifies further, in Section 402(b)(3), that any individual who represents an issuer in the offer or sale of the issuer's own securities is not an agent so long as the person is not compensated in connection with the sale of securities. A similar exemption exists under Section 402(b)(5) for sales of covered securities of the issuer so long as the person is not compensated in connection with the sale of securities. The uniform law drafting committee goes on in its official comments to state that "[u]nder Sections 402(b)(3) and (5) an agent may be exempt if acting for an issuer and receiving compensation, as long as the compensation is not a commission or other remuneration based on transactions in the issuer's own securities." As such, regular salary and benefits should not trigger agent registration requirements.

The following states have not adopted the USA in regards to registration of issuers as broker-dealers, or officers and directors as agents of the issuer, or taken other steps to prevent Regulation A issuers being caught by their broker-dealer registration requirements. In each case, except for New York, issuers can estimate the registration process taking approximately 30 to 60 days to complete, not including the time it takes to pass any required examination. Issuers should note that most states require the process to be complete within 90 days of application; the speed of the registration process is largely dependent on the speed and completeness of an issuer's responses to regulators' requests for additional information. New York requires that any filed paperwork be complete, but it does not review the filings.

Florida

Under Florida law, issuers making offers and sales of their own securities in or from the state are required to register with the Florida Division of Securities. Under Section 517.021(6)(a)(2) of the Florida Statutes, issuers are defined as dealers of securities. Florida law then requires, under Section 512.12(1) that "no … issuer of securities shall sell or offer for sale any securities … unless the [issuer] has been registered" with the Division of Securities as a dealer. While the statute exempts issuers from the registration requirements for the sale of certain securities, the exemption does not extend to public offerings of securities under Regulation A.

To register as an issuer-dealer in Florida, an issuer must submit a Form BD through the state's electronic filing system, as well as the Form OFR-DA-5-91: Issuer/Dealer Compliance Form in which the issuer seeks an examination waiver for its associated persons, audited financial statements and, if the date on the balance sheet is more than 90 days prior to the submission, an unaudited balance sheet as of a date within 90 days of submission, corporate governance documents, and a $200 filing fee.

The issuer must also register at least one associated person who must file a Form U4 along with a $50 registration fee per associated person. Issuers are allowed to register up to five associated persons who are then exempt from the examination process typically associated with registration of associated persons as associates of a dealer. The qualifying principal and all executive officers, directors and controlling persons named in the Form BD must submit fingerprints, even if they do not register as associated persons.

It should be noted that Florida requires any company registering as an issuer-dealer to have $25,000 in net capital available. This requirement effectively prevents uncapitalized, newly formed companies from being able to complete their registration as an issuer-dealer in Florida.

New York

New York has always been an outlier when it comes to regulation of securities. Rather than being based on any uniform standards, New York securities regulation is governed by its Martin Act, first adopted in 1921, and codified as Article 23-A of the New York General Business Law.

Under the Martin Act, issuers of securities are defined as dealers under Section 359-e(a). All issuers of securities are required to register as dealers in the state, unless the sale of securities is made through a registered broker on a firm commitment basis. Issuers making offers or sales of securities under Tier 2 of Regulation A are required to file the Form 99, the State Notice and Further State Notice, Form U-2, as well as the statutory filing fee of $1,200 ($1,950 for real-estate related issuers). The State of New York provides a helpful information sheet here.

New York does not require the separate registration of officers and directors of issuers as salespersons so long as those officers and directors are identified in the Form 99. However, if the issuer utilizes any salespersons that are not officers or directors, those salespersons are required to file the Form M-2, pay a fee of $150, and pass the FINRA Series 63 or Series 66 exam.

Texas

Section 4(C) of the Texas Securities Act provides for the registration of issuers as dealers when offers and sales are not made through a registered dealer. The specific language of the Act states, "any issuer … who, directly or through any person or company, other than a registered dealer, offers for sale, sells or makes sales of its own security or securities shall be deemed a dealer and shall be required to comply with the [dealer registration provisions]."

The specific registration requirements are found in Rule §115.2 of the State Securities Board. Issuers are required to file the Form BD, Form U4 for a designated officer and each agent to be registered, copies of the constitutive documents of the issuer, audited financial statements and, if the date on the balance sheet is more than 90 days prior to the submission, an unaudited balance sheet as of a date within 90 days of the submission date certified by the issuer's CFO on Form 133.18, and a $75 fee.

A designated officer is required to be registered. The issuer may be required to register agents as well if other officers and directors of the issuer are undertaking any selling activity. Rule §115.3 of the State Securities Board provides for the requirements for registration of such persons. In addition to the Form U4 filed with the Form BD, each of these people are required to have passed a securities exam accepted by the State Securities Board. For officers and directors or issuers selling their own securities under Tier 2 of Regulation A, passage of the Series 63 or Series 66 exam, or passage of a state administered exam is required. The State Securities Board has discretion to grant a waiver to the examination requirement. The filing fee for each person is $35.

States that require agent registration but not issuer-dealer registration

The following states provide for exemptions from the registration of the issuer entity as a dealer of securities, but may still require the registration of any officers and directors of the issuer as an agent. As mentioned above, states that have adopted some form of the USA provide for an exemption from registration for the officers and directors of the issuer in the instances of the person selling the securities of the issuer, and selling securities defined as covered securities under the Section 18 of the Securities Act. In the following states, registration as an agent is required of any officer or director undertaking selling efforts in the state, even if the officer or director does not receive transaction-based compensation. There is no exemption for an officer or director of an issuer selling the securities of the issuer, or those securities being covered securities.

It should be noted again that should any officer or director receive transaction-based compensation for the sales of securities of the issuer, no exemption from agent registration is available. That person will likely be required to register as an agent of the issuer in any state in which offers and sales of securities are made.

Alabama

Alabama does not provide for an exemption from registration as an agent for officers and directors of the issuer selling the securities of the issuer. As such, under Section 8-6-2(2) of the Alabama Securities Act, any officer or director representing an issuer in effecting sales of securities is defined as an agent of the issuer. An officer or director not undertaking any selling activities is not an agent of the issuer merely by being an officer or director. The officer or director must undertake selling efforts to require registration as an agent.

Section 830-X-3-.02 of the Alabama Administrative Code provides what information is required to register as an agent in the state. An agent of an issuer is required to register as a Restricted/Issuer Agent. The registration filing includes the Form U4, evidence of passage of the FINRA Series 63 or Series 66 exam, and a fee of $60.

Nevada

Similar to Alabama, Nevada does not provide an exemption from registration as a sales representative for officers and directors of the issuer selling the securities of the issuer. Under Section 90.285 of the Nevada Revised Statutes, any officer or director representing an issuer in effecting sales of securities is defined as sales representative of the issuer. An officer or director not undertaking any selling activities is not a sales representative of the issuer merely by being an officer or director. The officer or director must undertake selling efforts to require registration as a sales representative.

The registration requirement for sales representative of an issuer includes the filing of the Form U4, evidence of passage of the Series 63 or Series 66 exam, and a fee of $125. While Nevada has a provision to request a waiver from the exam requirements for officers and directors of the issuer under Section 90.372 of the Nevada Revised Statutes, that waiver is only available for registered offerings and offerings under Rule 506 of Regulation D.

New Jersey

A straight reading of New Jersey's laws and regulations would lead a reader to believe that New Jersey provides both an exemption for issuers and salespersons of an issuer. However, on January 3, 2017, the New Jersey Bureau of Securities issued a Notice of Statutory Construction identifying that the provisions providing exemption from registration for agents of an issuer is only applicable to offerings under Rule 506 of Regulation D, and not to offerings under Tier 2 of Regulation A.

Section 49:3-56 of the New Jersey Securities Act provides for the registration of issuer-agents. The specific registration requirements are in Sections 13:47-3.3 and 13:47-4.2 and 4.4 of the New Jersey Administrative Code. An officer of the company must submit a Form U4, a Form NJBOS4 authorizing the state to conduct a criminal history background check and fingerprints, together with a $60 filing fee. The agent must also complete Form NJBOS5 online to request an examination waiver.

Washington

Washington excludes from its definition of broker-dealer an issuer of securities. However, any "salesperson" is required to register with the Washington Securities Division. Under Section 21.20.005 of the Revised Code of Washington, salesperson includes any person who represents an issuer in effecting or attempting to effect the sales of securities. The State of Washington has interpreted this language to include the officers and directors of an issuer.

Chapter 460-23B of the Washington Administrative Code sets out the registration requirements for salespersons for issuers. A salesperson must submit a Form U4, together with a filing fee of $40. An officer or director of an issuer that is a corporation or general partner or manager of an LLC that seeks to register in connection with a single offering of the issuer and who will receive no commissions or similar remuneration directly or indirectly in connection with the offer or sale of the issuer's securities does not need to pass an examination.

Consequences of not registering

In general, there can be severe consequences for an issuer not registering as a dealer or agent where required. These consequences include liability to state regulators and investors in any offering.

Regulatory enforcement consequences

State regulators have the authority to issue cease and desist orders, civil penalties, and criminal penalties. Some of these penalties may trigger "Bad Actor" disqualification provisions, hindering the issuer's future capital raising activities.

Alabama's regulatory history also provides insight into enforcement against officers and directors of issuers that did not register as agents when required. In a 2010 enforcement action, Alabama issued a cease and desist order due to a director's failure to register as an agent in the state. The cease and desist order notes that other potential administrative remedies could include monetary fines and a permanent bar from participating in any securities related activity in the state.

In applying the Martin Act, under Section 352-i, New York has determined that failure to register as a dealer of securities when making an offer or sale of securities in the state can be deemed a fraudulent

practice. While considered a fraudulent practice, most orders involve a fine and instructions to register as a dealer in the state.[1]

Florida considers any act in violation of its Securities and Investor Protection Act to be a third degree felony under Section 517.302.[2] The Florida Office of Financial Regulation has published a helpful overview of its disciplinary guidelines for non-compliance with statutes or rules governing the registration and operations of issuer-dealers. Based on the judgment of the severity of the violation, non-registration as an issuer-dealer may simply result in a notice of non-compliance, or may include a fine of $2,000 to $10,000, suspension of the ability to register as an issuer-dealer in the state, or even a complete bar from registration as an issuer-dealer.[3]

Issuers should be aware that suspensions of the ability to register as an issuer-dealer or agent, or bans on registration are disqualifying events under the SEC's Bad Actor Rule. This means that while the suspension or ban is in place, the issuer would be disqualified from the use of Rule 506 of Regulation D, Regulation A, or Regulation CF. Any selling activities continuing while the disqualification is in place would constitute a violation of Section 5 of the Securities Act, leading to additional liability and further disqualifications under the SEC's Bad Actor Rule.

Further, a violations of New York's issuer-dealer registration rules is defined as a fraudulent practice, which comes with a Bad Actor disqualification for 10 years.

Investor civil remedies

Additionally, issuers may be liable to investors for not registering as a dealer where required. Typically, an investor who purchases a security from an issuer that is required to register as a dealer or have an officer or director register as an agent, but did not so register, may sue for rescission or damages. A purchaser would seek rescission when that purchaser is still in possession of the security, and would seek damages if the purchaser had disposed of the security.

In the case of a Regulation A offering where there is limited liquidity, the liability is most likely to be rescission. Rescission requires that the issuer reset the entire transaction with the purchaser. Essentially, the investor has a two or three year put (depending on the statute of limitations) for receiving the return of their entire investment, plus interest. For a cash-strapped early stage company, returning all of the invested funds could be a company terminating event.

In Florida, Section 517.211 provides that any sale made when the issuer is in violation of its issuer-dealer registration requirements may be rescinded as the election of the purchaser, with interest and attorney

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[1] *See*, *e.g.*, *People ex rel. Vacco v. World Interactive Gaming Corp.,* 185 Misc. 2d 852, 863-64, 714 N.Y.S.2d 844, 853 (Sup. Ct. 1999).

[2] *See*, *e.g.*, *Robert Paul Murphy, Petitioner v. Board of Hearing Aid Specialists, Respondent*, 2016 WL 349583, at *4.

[3] *See*, *e.g.*, *Department of Banking and Finance, Division of Securities v. Boca Insurance Lenders*, 1996 WL 636843, at *2.

fees.[4] Florida goes further and provides that any control person of the issuer involved in making the sale is jointly and severally liable to the purchaser.

Section 33(a)(1) of the Texas Securities Act provides that any person who offers or sells securities in violation of Section 12, which requires issuer registration as a dealer for those offerings that are not exempted, is liable to the purchaser of the security.

Conclusion

The SEC's 2015 amendments to Regulation A provide increased opportunities for companies to make offers and sales of their securities directly to investors without the utilization of a registered broker-dealer. This is primarily due to the Regulation A specific communication rules that allow for more open communication that can be accomplished in innovative ways.

Tier 2 of Regulation A also provides for preemption of state registration of the offer and sale of the security, but does not preempt state rules relating to the registration of the issuer as a dealer, or registration of officers or directors of the issuers as agents. While most states do not have such a registration requirement, the states of Florida, New York, and Texas require registration of the issuer as a dealer of securities and corresponding agent registration. Additionally, the states of Alabama, New Jersey, Nevada, and Washington require the registration of officers and directors undertaking selling activities as an agent of the issuer.

Failure to register where required comes with potentially severe consequences. States have the authority to make cease and desist demands, institute fines, or order suspensions or bars from participation from securities related activity in the state. Any suspension or bar qualifies as a Bad Act under the SEC's Bad Actor Rule, thereby disqualifying the issuer from relying on Regulation D, Regulation A, or Regulation CF. Issuers also face liability to individual investors who would have the right to demand rescission of the investment.

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[4] *See*, *e.g.*, *Cifuentes v. Regions Bank*, No. 11-23455-CIV, 2012 WL 2339317, at *1 (S.D. Fla. June 19, 2012).