

Date of Hearing: April 29, 2021

ASSEMBLY COMMITTEE ON BANKING AND FINANCE  
Timothy Grayson, Chair  
AB 511 (Muratsuchi) – As Amended April 22, 2021

**SUBJECT:** Securities transactions: qualification requirements, exemptions, and liability

**SUMMARY:** Exempts from state securities qualifications requirements certain crowdfunded equity offerings. Specifically, this bill;

- 1) Exempts any offer or sale of any security that meets each of the following criteria:
  - a) The issuer meets all of the following criteria:
    - i. Is a California corporation or a foreign corporation that is subject to specified requirements under current state law, and neither corporation is a “blind pool” company as defined by the commissioner.
    - ii. Is not issuing fractional undivided interests in oil or gas rights a similar interest in other minerals rights.
    - iii. Is not an investment fund, defined as a company subject to the Investment Company Act of 1940.
    - iv. Is not a public company, defined as being subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Acts of 1934.
  - b) The offering is conducted in accordance with specified intrastate offering exemptions under federal law as well as in accordance with Regulation CF, which is the federal regulation governing security offerings through crowdfunding, except as follows:
    - i. The aggregate amount of securities sold to all investors by the issuer during the 12-month period preceding the sale cannot exceed \$300,000.
    - ii. The issuer may comply with federal regulations that require the issuer to include accounting statements certified by management of the corporation to be accurate rather than accounting statements reviewed by an independent public accountant.
    - iii. The issuer must provide a statement that financial information certified by the principal executive officer of the issuer has been provided instead of financial statements reviewed by an independent public accountant. The aggregate offering price for all securities sold.
  - c) The issuer has taken reasonable steps to ensure that each purchaser who is a natural person and not an accredited investor, as defined, has knowledge and experience in financial and business matters and that they are capable of evaluating the merits and risks of the prospective investment.
  - d) The issuer cannot require or impose an obligation on any purchaser or potential purchaser to waive the right to a jury trial in a court action, be bound by or subject to any law other

than California law, and file or resolve any claim or dispute in any forum other than California.

- e) The issuer must file, on a form prescribed by the commissioner, a notice of transactions at least 15 days prior to the publication of an initial offer of securities. The commissioner has the authority to assess an administrative penalty of up to \$1,000.
- f) Require the court to award reasonable attorney's fees and costs to a prevailing purchaser or seller for certain violations of state securities laws.

**EXISTING LAW:**

- 1) Provides the Corporate Securities Law of 1968, which governs the issuance and sale of securities in California. The law is administered by the Department of Financial Protection and Innovation (DFPI). (Corporations Code Sections 25000 et seq.)
- 2) Provides that it is unlawful for any person to offer or sell any security in this state, unless such sale has been qualified by DFPI, as specified, or the sale is covered by an express exemption from qualification. (Corporations Code Section 25110)
- 3) Exempts certain securities from qualification requirements, meaning the issuer does not need the approval of DFPI to offer securities to potential investors, as specified. (Corporations Code Section 25100)

**FISCAL EFFECT:** Unknown. This bill is keyed fiscal by Legislative Counsel.

**COMMENTS:**

1) PURPOSE

According to the author:

Small businesses, accounting for over two-thirds of new jobs nationally, often lack access to capital and rely heavily on credit card debt, home equity and limited personal assets for financing. Crowdfunding enables entrepreneurs to prove a concept, build infrastructure necessary to support a business model and take other steps necessary to attract capital investment. For small businesses and start-ups, however, raising capital frequently can be an overwhelming challenge.

AB 511 would allow start-up and emerging small businesses to find investors who can provide capital to help them grow and create jobs, while providing greater protections to California investors participating in crowdfunding. This bill offers both entrepreneurs and investors a safer means of filling the "capital gap" that exists for smaller early-stage seed capital offerings while helping to jumpstart companies so that they can become candidates for larger rounds of financing.

2) BACKGROUND

At the most general level, a security is an investment in a business. Securities can take a variety of forms – stocks, bonds, bundled mortgages, or certain digital assets, for example. A securities offering is the process whereby a company issues or sells its securities to investors,

such as when a company issues shares via an initial public offering (IPO). One feature of American capital markets is investors' trust in the offering process – that representations made by an issuer are reasonable and based in fact and that fraudulent or deceptive behavior can be remedied through the judicial system.

Federal law provides the regulatory foundation of securities offerings. Congress passed the Securities Act of 1933 in response to the bad behavior that fueled the run-up and ultimate crash of the stock market in the 1920s. Prior to the Securities Act, a patchwork of state level “blue sky laws” provided some protections to investors but proved insufficient for the exuberance of the Roaring Twenties. Among other things, the Securities Act requires a company to file a registration statement containing information about itself, the securities it is offering, and the offering, unless the offering qualifies for an exemption. Federal and state law worked in parallel for several decades, layering requirements on the securities offerings process. In 1996 Congress passed the National Securities Market Improvement Act (NSMIA), which preempted state law for many large and interstate offerings.

Today state securities law related to offerings is largely focused on fraud prevention and qualification requirements for relatively smaller offerings. Examples of offerings exempt from federal registration requirements, but potentially required to qualify by permit at the state level include:

- Offerings of less than \$5 million that meet the exemption specified in Rule 504 or Regulation D.
- Offerings of less than \$20 million that meet the exemption requirements of a Regulation A – Tier 1 offering.
- Intrastate offerings where the company is organized in California, carries out a significant amount of its business in California, and makes offers and sales of its securities only to residents of California.

The qualification by permit process requires an issuer to submit a lengthy questionnaire and all offering documents to DFPI for review before money is raised from investors. Except for certain small offerings, DFPI may review the fairness of the offering and impose additional restrictions on the offering. For small offerings to bypass the fairness review, the law provides minimum investment standards related to a potential investor's income and/or net worth.

### 3) JOBS Act and Regulation CF

In 2012 Congress passed the Jumpstart Our Business Startups (JOBS) Act that was signed into law by President Obama. In response to the languid recovery in small business activity since the Great Financial Crisis, the JOBS Act was intended to increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies. As the bill was debated in Congress, the Act was criticized by

advocacy groups and securities regulators for removing obligations designed to protect investors.<sup>1,2</sup>

The law eases a variety of securities regulations, but the section of the JOBS Act authorizing “equity crowdfunding” is most relevant to this bill. Equity crowdfunding provides a platform for private corporations to offer their shares to the public through an online platform or portal. This method of raising capital is popular with startup companies and small businesses seeking relatively small funding rounds. Pursuant to the JOBS Act, the Securities and Exchange Commission (SEC) promulgated Regulation CF, which preempts state qualification requirements. Among other things, Reg CF:

- Requires all transactions issued pursuant to Reg CF to take place online through an SEC-registered intermediary, either a broker-dealer or a funding portal.
- Permits a company to raise a maximum aggregate amount of \$5 million through crowdfunding offerings in a 12-month period.<sup>3</sup>
- Limits the amount individual investors can invest across all crowdfunding offerings in a 12-month period.
- Requires disclosure of information in filings with the Commission and to investors and the intermediary facilitating the offering.<sup>4</sup>

Proponents argue that equity crowdfunding broadens access and lowers the cost of capital for early stage companies. Some proponents also argue that crowdfunding opens access to smaller, less sophisticated investors to invest in start-ups with potential for high returns. Critics raise concerns that eliminating or watering down disclosure requirements could put investors at higher risk of fraud or corporate mismanagement. Both supporters and critics were not fully satisfied with the compromise enshrined in the JOBS Act, but the Act remains the prevailing law at the federal level and preempts any conflicting law at the state level.

#### 4) STATE-LEVEL CROWDFUNDING AND RECENT EFFORTS IN CALIFORNIA

Thirty-four states and the District of Columbia have enacted state-level crowdfunding exemptions to their securities laws.<sup>5</sup> These exemptions vary between states but generally require less stringent disclosures and do not require issuers to offer securities through an SEC-registered intermediary. State exemptions, however, are typically limited to corporations domiciled in the state and prohibit issuers from offering securities to residents of other states.

Over the past decade, Small Business California, the sponsor of this bill, has sponsored several bills intended to ease the costs of offering shares by reducing or eliminating disclosure requirements and other prohibitions in state securities law. Previous efforts,

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<sup>1</sup> <https://www.sfgate.com/business/article/Financial-regulations-gutted-in-new-bill-3407178.php>

<sup>2</sup> <https://www.nytimes.com/2012/03/11/opinion/sunday/washington-has-a-very-short-memory.html>

<sup>3</sup> Original rule permitted a maximum offering of \$1.07 million. The SEC increased the limit by rule in November 2020 to \$5 million.

<sup>4</sup> <https://www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding>

<sup>5</sup> <https://www.nasaa.org/industry-resources/securities-issuers/intrastate-crowdfunding-directory/>

including AB 2081 (Allen) of 2012, AB 2096 (Muratsuchi) of 2014, AB 722 (Parea) of 2015, and AB 2178 (Chiu) of 2016, proposed a variety of exemptions to state securities law that brought opposition from PIABA, an international bar association who members represent investors in disputes with the securities industry. Whether due to policy concerns or fiscal effects of the bills, none of the legislation made it through both houses of the Legislature.

5) **THIS BILL TAKES A MODEST APPROACH TO EASING REQUIREMENTS FOR SMALL OFFERINGS**

Unlike previous proposals from the sponsor, this bill proposes a modest exemption for small offerings and provides a number of investor protections in return. This bill would enact an exemption from qualification requirements for an offering that followed all of the requirements of Regulation CF, except the bill would allow an offering of less than \$300,000 to include accounting statements certified by management of the corporation to be accurate, rather than accounting statements reviewed by an independent public accountant. Reg CF already allows this for offerings below \$107,000.

In exchange for this modest exemption relative to prevailing federal law, this bill prohibits an issuer to require or impose an obligation on any purchaser or potential purchaser to do the following: waive the right to a jury trial, be subject to any law other than California law, or file or resolve any claim or dispute in any forum other than California. The bill also requires a judge to award reasonable attorney's fees to a prevailing investor for specified violations of state securities law, which provides a stronger incentive for attorneys to take on complaints from small investors that would normally be uneconomical without a guarantee of recovering costs via judgment.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California Chamber of Commerce  
California Hispanic Chamber of Commerce  
Flasher Barricade Association  
National Association of Women Business Owners - California  
National Association of Women Business Owners California - Sacramento Valley Chapter  
National Federation of Independent Business - California  
Small Business California  
Small Business Majority

**Opposition**

None on file.

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