

STATE CORPORATION COMMISSION

AT RICHMOND, APRIL 29, 2020

*Document Control Center 04/29/20@2.43 PM*COMMONWEALTH OF VIRGINIA, *ex rel.*

STATE CORPORATION COMMISSION

Ex Parte: In the matter of
Adopting a Revision to the Rules
Governing the Virginia Securities Act

CASE NO. SEC-2020-00022

ORDER TO TAKE NOTICE

Section 12.1-13 of the Code of Virginia ("Code") provides that the State Corporation Commission ("Commission") shall have the power to promulgate rules and regulations in the enforcement and administration of all laws within its jurisdiction. Section 13.1-523 of the Virginia Securities Act ("Act"), § 13.1-501 *et seq.* of the Code provides that the Commission may issue any rules and regulations necessary or appropriate for the administration and enforcement of the Act.

The rules and regulations issued by the Commission pursuant to the Act are set forth in Title 21 of the Virginia Administrative Code. A copy also may be found at the Commission's website: <https://scc.virginia.gov/pages/Case-Information>.

The Division of Securities and Retail Franchising ("Division") proposes revisions to Chapter 40 (Exempt Securities and Transactions), 21 VAC 5-40-10 *et seq.*, following recent legislative changes to the Act. Specifically, the Division seeks to: (a) amend 21 VAC 5-40-190 concerning the Intrastate Crowdfunding Exemption; and (b) create a new rule (21 VAC 5-40-200) allowing an exemption for non-issuer distribution.

I. Amendment to the Intrastate Crowdfunding Exemption in 21 VAC 5-40-190.

The 2015 General Assembly passed legislation to adopt an exemption from registration under certain conditions for intrastate offerings pursuant to crowdfunding in § 13.1-514 B 21 (g) of the Virginia Securities Act ("Act"), § 13.1-501 *et seq.* of the Code of Virginia. The legislation was set to sunset on July 1, 2020. The exemption only applied to issuers that were corporations and entities formed under the laws of Virginia, authorized to do business in Virginia, and that had their principal place of business in Virginia. On July 31, 2015, the Commission adopted 21 VAC 5-40-190 concerning the requirements for the exemption.

During the 2020 legislative session, the General Assembly passed House Bill 1339 (Chapter 331 of the 2020 Acts of the Assembly) and Senate Bill 542 (Chapter 279 of the 2020 Acts of the Assembly). First, this legislation removed the sunset provision of the exemption. Second, the legislation broadened the exemption to allow corporations and entities that are Virginia-based but organized outside of Virginia to also claim the exemption.

The Division of Securities and Retail Franchising ("Division") proposes to amend 21 VAC 5-40-190 to conform the regulation to this recent legislative change by adding Rule 147 A (17 C.F.R. §230.147A) issuers to the exemption. In addition, to further implement the intent of the legislation and promote small businesses, the Division will remove the prohibition on debt offerings for crowdfunding issuers.

II. Adding an Exemption for Non-Issuer Distribution (21 VAC 5-40-200).

The 2020 General Assembly passed House Bill 1457 (Chapter 256 of the Acts of the Assembly) that amended §13.1-514 B of the Act by adding a new subsection 23 that provides for a self-executing exemption for non-issuer distribution by securities issuers whose securities are listed on an electronic exchange, marketplace system, or disclosure repository which that makes

information freely available to the public and is registered with the SEC under the Securities and Exchange Act of 1934, or is an alternative trading system regulated by the SEC.

A non-issuer distribution occurs in the secondary market and allows purchasers to freely purchase and sell securities that were originally purchased from the original issuer. A self-executing exemption allows the purchaser or seller to use the exemption without registration under the Act.

To implement the new legislation, the Division proposes adding a new section 21 VAC 5-40-200 for this exemption. As noted above, the exemption may apply to issuers whose securities are listed on an electronic exchange, marketplace exchange or disclosure repository, or alternative trading system that meet certain requirements. Here, the Division proposes that the new exemption apply only to those issuers whose securities are listed on the OTC Markets Group ("OTG") OTCQX, as this tier applies the strictest listing standards of the electronic markets.

As of this date of this Order, roughly thirty-two states have a similar exemption that recognizes transactions placed on the OTCQX Tier.

The Division recommended to the Commission that the proposed revisions should be considered for adoption. The Division also has recommended to the Commission that a hearing should be held only if requested by those interested parties who specifically indicate that a hearing is necessary and the reasons therefore.

A copy of the proposed revisions may be requested by interested parties from the Division by e-mail request and also can be found at the Division's website:

www.scc.virginia.gov/srf. Any comments to the proposed rules must be received by

June 8, 2020.

IT IS THEREFORE ORDERED that:

(1) The proposed revisions are appended hereto and made a part of the record herein.

(2) Comments or request for hearing on the proposed revisions must be submitted in writing to Joel H. Peck, Clerk of the Commission, c/o Document Control Center, P. O. Box 2118, Richmond, Virginia 23218, on or before June 8, 2020. Requests for hearing shall state why a hearing is necessary and why the issues cannot be adequately addressed in written comments. All correspondence shall reference Case No. SEC-2020-00022. Interested persons desiring to submit comments electronically may do so by following the instructions available at the Commission's website: <https://scc.virginia.gov/casecomments/Submit-Public-Comments>.

(3) The proposed revisions shall be posted on the Commission's website at <https://scc.virginia.gov/pages/Case-Information> and on the Division's website at <http://www.scc.virginia.gov/srf>. Interested persons may also request a copy of the proposed revisions from the Division by e-mail.

A COPY HEREOF, together with a copy of the proposed revisions, shall be provided to the Registrar of Regulations for appropriate publication in the *Virginia Register of Regulations*.

A COPY HEREOF shall be sent to the Director of the Division of Securities and Retail Franchising, who shall forthwith provide notice of this Order via U.S. mail or e-mail a copy of this Order to any interested persons as he may designate.

STATE CORPORATION COMMISSION, DIVISION OF SECURITIES AND RETAIL
FRANCHISING

2020 Securities RulePackage SEC-2020-00022

21VAC5-40-190. Intrastate crowdfunding exemption.

A. In accordance with § 13.1-514 B 21 of the Act, an offer or sale of a security by an issuer is exempt from the securities, broker-dealer and agent registration requirements of the Act if the offer or sale meets all of the following requirements:

1. The issuer of the security is a business entity:
 - a. Formed under the laws of the Commonwealth; however, (i) if conducting an offering in accordance with SEC Rule 147A the issuer may be formed and organized outside the Commonwealth provided they meet one of the requirements as stated in subdivision 3 of this subsection;
 - b. Authorized to do business in the Commonwealth; and
 - c. That has its principal place of business in the Commonwealth.
2. The offering is sold only to residents of the Commonwealth in compliance with the requirements for the federal exemption for intrastate offerings under § 3(a)(11) of the Securities Act of 1933, 15 USC 77c(a)(11), and SEC Rule 147, 17 CFR 230.147- or SEC Rule 147A. If an offering is conducted by an issuer using SEC Rule 147A the offering may be made available to residents outside the Commonwealth as long as the sale of the security is made to residents of the Commonwealth.

~~3. The securities offered and sold pursuant to this exemption are equity securities of the issuer. This exemption is not available to debt offerings. Issuers utilizing SEC Rule 147A that are not formed under the laws of the Commonwealth must meet one of the following requirements of conducting business in the Commonwealth.~~

a. The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in the Commonwealth or from the rendering of services in the Commonwealth.

b. The issuer had at least 80% of its consolidated assets located in the Commonwealth.

c. The issuer intends to use and uses at least 80% of the net proceeds from the offering towards the operation of a business or of real property in the Commonwealth, the purchase of real property located in the Commonwealth, or the rendering of services in the Commonwealth.

d. A majority of the issuer's employees are based in the Commonwealth.

4. The sum of all cash and other consideration to be received for all sales of the securities in reliance on this exemption does not exceed \$2 million, less the aggregate amount received for all sales of securities by the issuer within 12 months before the first offer or sale made in reliance upon this exemption, and if the offering is:

a. \$500,000 or less, if the issuer has financial statements prepared the previous year that have been certified by the principal executive officer of the issuer to be true and complete in all material respects;

b. More than \$500,000 but less than \$1 million, if the issuer has undergone a financial review of the financial statements of its most recently completed fiscal year, conducted by an independent certified public accountant in accordance with generally accepted accounting principles; or

- c. \$1 million or more, if the issuer has undergone an audit of the financial statements of its most recently completed fiscal year, conducted by an independent certified public accountant in accordance with generally accepted accounting principles.
5. The issuer has not accepted more than \$10,000 from any single purchaser unless the purchaser is an accredited investor as defined by Rule 501 of SEC Regulation D, 17 CFR 230.501.
6. At least 20 days before an offer of securities is made in reliance on this exemption or the use of any publicly available Internet website in connection with an offering of securities in reliance on this exemption, the issuer files with the commission in writing or in electronic form, all of the following:
- a. A notice of claim of exemption from registration on Form ICE specifying that the issuer intends to conduct an offering in reliance on this exemption, accompanied by a nonrefundable filing fee of \$250 payable to the Treasurer of Virginia.
 - b. A copy of the disclosure statement or Form ICE to be provided to prospective investors in connection with the offering. The disclosure statement or Form ICE shall contain all of the following:
 - (1) A description of the issuer, including type of entity, the address and telephone number of its principal office, its formation history, and its business plan;
 - (2) A description of the intended use of the offering proceeds, including any amounts to be paid, as compensation or otherwise, to any owner, executive officer, director, managing member, or other person occupying a similar status or performing similar functions on behalf of the issuer;

(3) The identity of each person that owns more than 10% of the ownership interests of any class of securities of the issuer and the amount of said securities held by such person;

(4) The identity of the executive officers, directors, or managing members of the issuer and any other individuals who occupy similar status or perform similar functions in the name of and on behalf of the issuer, including their titles and their prior business experience;

(5) The terms and conditions of the securities being offered including:

(a) The type and amounts of any outstanding securities of the issuer;

(b) The minimum and maximum amount of securities being offered, if any;

(c) Either the percentage ownership of the issuer represented by the offered securities or the valuation of the issuer implied by the price of the offered securities;

(d) The price per share, unit, or interest of the securities being offered;

(e) Any restrictions on transfer of the securities being offered; and

(f) A disclosure of any anticipated future issuance of securities that might dilute the value of the securities being offered;

(6) The identity of any person that the issuer has or intends to retain to assist the issuer in conducting the offer and sale of the securities, including the owner of any websites, if known, but excluding any person acting solely as an accountant or attorney and any employees whose primary job responsibilities involve the operating business of the issuer rather than assisting the issuer in raising capital;

(7) For each person identified as required in subdivision 6 b (6) of this subsection, a description of the consideration being paid to the person for such assistance;

(8) A description of any litigation or legal proceedings involving the issuer or any executive officer, director, or managing member or other person occupying a similar status or performing similar functions on behalf of the issuer;

(9) The issuer's financial statements for the three most recent fiscal years or for as much time as the issuer has been in existence, if less than three years;

(10) The name and address, including the uniform resource locator, of each Internet website that will be used by the issuer to offer or sell securities under an exemption under this section; and

(11) Any additional information material to the offering, including, if appropriate, a discussion of significant risk factors that make the offering speculative or risky. This discussion shall be concise and organized logically and may not be limited to risks that could apply to any issuer or any offering.

c. An escrow agreement with a bank or other depository institution located in this Commonwealth, in which the purchaser funds will be deposited. At a minimum the escrow agreement shall provide that all offering proceeds will be released to the issuer only when the aggregate capital raised from all purchasers is equal to or greater than the minimum target offering amount specified in the disclosure statement as necessary to implement the business plan and all purchasers will receive a return of their subscription funds if that target offering amount is not raised by the time stated in the disclosure statement. The depository institution may contract with the issuer to collect reasonable fees for its escrow services regardless of whether the target offering amount is reached; however such fees shall not be deducted from purchaser funds if the target offering amount is not raised by the time stated in the disclosure statement. The issuer shall disclose in its disclosure statement or Form ICE whether any interest

earned on escrowed purchaser funds will be paid to purchasers on a pro rata basis if the minimum target amount, as described above, is not raised.

7. The issuer is not, either before or as a result of the offering:

a. A company that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, including an investment company as defined by 15 USC § 80a-3, or a hedge fund, commodity pool, or similar investment vehicle;

b. Subject to the reporting requirements of § 13 or 15(d) of the Securities Exchange Act of 1934, 15 USC 78m and 78o(d);

c. A company that has not yet defined its business operations, has no business plan, has no stated investment goal for the funds being raised, or that plans to engage in a merger with or acquisition of an unspecified business entity or entities, or without an allocation of proceeds to sufficiently identifiable properties or objectives; or

d. A company that is engaged in or proposes to engage in petroleum exploration or production, mining, or other extractive industries.

8. The issuer informs each prospective purchaser that the securities are not registered under federal or state securities laws and that the securities are subject to limitations on transfer or resale and displays the following legend conspicuously on the cover page of the disclosure statement:

THESE SECURITIES ARE BEING SOLD IN RELIANCE ON AN EXEMPTION TO THE FEDERAL SECURITIES REGISTRATION REQUIREMENTS UNDER SECTION 3(a)(11) OF THE SECURITIES ACT OF 1933 AND UNDER SECTION 13.1-514 OF THE VIRGINIA SECURITIES ACT. THESE SECURITIES CAN ONLY BE SOLD TO RESIDENTS OF VIRGINIA AND ARE SUBJECT TO RESTRICTIONS ON

TRANSFERABILITY AND RESALE AS CONTAINED IN SUBSECTIONS (e) AND (f) OF SEC RULE 147, 17 CFR 230.147. INVESTORS SHOULD BE AWARE THAT THEY WILL BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME AND THAT THEY MAY LOSE ALL OF THE INVESTMENT AND CAN AFFORD THE LOSS OF THE INVESTMENT. IN MAKING AN INVESTMENT DECISION, INVESTORS SHOULD RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS REVEALED IN THESE OFFERING DOCUMENTS, INCLUDING THE MERITS AND RISKS INVOLVED.

THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE AUTHORITY OR REGULATORY COMMISSION NOR HAVE THESE ENTITIES CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

9. If the offer and sale of securities under this section is made through the Internet, all of the following requirements are met:

- a. Any person acting as the Internet website operator shall be an issuer, a registered broker-dealer, or a funding portal that is in compliance with all commission, SEC, and FINRA requirements, including, if it is a funding portal, making any required notice filings with the commission;
- b. Internet website operators shall comply with all commission, SEC, and FINRA requirements applicable to intrastate offerings through the Internet;
- c. Internet website operators shall maintain records of all offers and sales of securities effected through its Internet website for five years from the close of the offering; and

- d. The issuer and the Internet website operator shall keep and maintain records of the offers and sales of securities made through the Internet website for five years from the close of the offering. The issuer and the Internet website operator shall promptly provide ready access to the records to the commission on request. The commission may access, inspect, and review any Internet website described in this subdivision 9 and its records.
10. All payments for the purchase of securities are directed to and held by the depository institution subject to the provisions of subdivision 6 c of this subsection.
11. The issuer does not pay, directly or indirectly, any commission or remuneration to an executive officer, director, managing member, or other individual who has a similar status or performs similar functions in the name of and on behalf of the issuer for offering or selling the securities unless he is registered as a broker-dealer agent under the Act. An executive officer, director, managing member, or other individual who has a similar status or performs similar functions in the name of and on behalf of the issuer is exempt from the agent registration requirements of the Act if he does not receive, directly or indirectly, any commission or remuneration for offering or selling securities of the issuer that are exempt from registration under this section.
12. The issuer provides a copy of Form ICE or the disclosure statement provided to the commission under subdivision 6 b of this subsection to each prospective purchaser at the time the offer of securities is made to the prospective purchaser.
13. The term of the offering does not exceed 12 months after the date of the first offer.
- B. The issuer shall provide an annual report to the issuer's purchasers for each of the issuer's next three fiscal years, the first of which being that fiscal year that ends following the

commencement of the offering. All of the following apply to the annual report described in this subsection:

1. The issuer shall provide the report free of charge to the purchasers;
 2. An issuer may satisfy the report requirement under this subsection by making the information available on an Internet website if the information is made available within 45 days after the end of each fiscal year and remains available until the next annual report is issued;
 3. The issuer shall file each report with the commission and shall provide a written copy of the report to any purchaser on request; and
 4. The report shall include all of the following:
 - a. The compensation received by each director and executive officer of the issuer, including cash compensation earned since the previous report and on an annual basis and any bonuses, stock options, other rights to receive securities of the issuer or any affiliate of the issuer, or other compensation received; and
 - b. An analysis by management of the issuer's business operations and financial condition.
- C. The exemption provided in this section shall not be used in conjunction with any other exemption under the Act, except offers and sales to control persons shall not count toward the limitation in subdivision A 4 of this section.
- D. The exemption described in this section shall not be available to the issuer if the issuer, any of the issuer's predecessors, any affiliate of the issuer, or any control person of the issuer:

1. Within the past 10 years, has filed a registration statement that is the subject of a currently effective registration stop order entered by any state securities administrator or the SEC;
2. Within the past 10 years, has been convicted of any criminal offense in connection with the offer, purchase, or sale of any security, or involving fraud or deceit;
3. Is currently subject to any state or federal administrative enforcement order or judgment, entered within the past 10 years, finding fraud or deceit in connection with the purchase or sale of any security; or
4. Is currently subject to any order, judgment, or decree of any court of competent jurisdiction, entered within the past 10 years, that temporarily, preliminarily, or permanently restrains or enjoins the party from engaging in or continuing to engage in any conduct or practice involving fraud or deceit in connection with the purchase or sale of any security.

E. Subsection D of this section shall not apply if:

1. The party subject to the disqualification is licensed or registered to conduct securities-related business in the state in which the order, judgment, or decree creating the disqualification was entered against such party;
2. Before the first offer under this exemption, the state securities administrator, or the court or regulatory authority that entered the order, judgment, or decree, waives the disqualification; or
3. The issuer establishes it did not know and exercising reasonable care, based on a factual inquiry, could not have known that a disqualification existed under this subsection.

F. An Internet website through which an offer or sale of securities under this section is made is not subject to the broker-dealer or agent registration requirements of the Act if the Internet website meets all of the following conditions:

1. It does not offer investment advice or recommendations;
2. It does not solicit purchases, sales, or offers to buy the securities offered or displayed on the Internet website;
3. It does not compensate employees, agents, or other persons for the solicitation or based on the sale of securities displayed or referenced on the Internet website; and
4. It does not hold, manage, possess, or otherwise handle purchaser funds or securities.

G. As used in this section, "financial review" means a limited inquiry and analytical procedure of much narrower scope than an audit, undertaken by a certified public accountant for the purpose of expressing limited assurance that financial statements are presented in accordance with generally accepted accounting principles.

H. As used in this section, "control person" means (i) an officer, director, partner, managing member, trustee, or other person having the power, directly or indirectly, to direct the management or policies of the issuer, whether by contract or otherwise; or (ii) a person that owns 10% or more of any class of the outstanding securities of the issuer.

I. As used in this section, "funding portal" means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to § 4(6) of the Securities Act of 1933 that does not:

1. Offer investment advice or recommendations;
2. Solicit purchases, sales, or offers to buy the securities offered or displayed on its Internet website or portal;
3. Compensate employees, agents, or other persons for such solicitation or based on the sales of securities displayed or referenced on its Internet website or portal;
4. Hold, manage, possess, or otherwise handle investor funds or securities; or

5. Engage in such other activities as the SEC, by rule, determines inappropriate.

J. The issuer or other designated person shall be notified by letter or electronic communication when the exemption filing is effective. If, however, on or before the initial commencement date of the offering, and after timely filing the materials required by subdivision A 6 of this section with the commission, the issuer has not been notified that any one or more of the filed materials fails to conform to the requirements of this section, the proposed offering shall be deemed effective.

K. Upon completion of an offering made in reliance on this exemption, the issuer shall file a final sales report with the commission, by letter or electronic communication, no later than 30 days after the last sale in the offering that includes the following information:

1. The time period in which the offering was open;
2. The number of investors that purchased shares or units in the offering;
3. The dollar amount sold in the offering; and
4. The dollar amount, if any, returned to investors, purchasers, or subscribers.

21VAC5-40-200. Nonissuer distribution.

A. In accordance with § 13.1-514 B 23 of the Act, an offer or sale of a security by an issuer is exempt from the securities, broker-dealer and agent registration requirements of the Act if the offer or sale meets all of the following requirements:

1. Securities involved in these transactions are for nonissuer distribution only; and

2. Securities in these transactions are to be limited to the OTCQX Market Tier of the OTC Market.