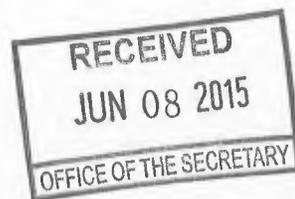


SECURITIES AND EXCHANGE COMMISSION
AMENDMENTS FOR SMALL AND ADDITIONAL ISSUES EXEMPTIONS UNDER THE
SECURITIES ACT (REGULATION A); FINAL RULE
Release Nos. 33-9741; 34-74578; 39-2501; File No. S7-11-13
RIN 3235-AL39
80 Fed. Reg. 21,806 (Apr. 20, 2015)

**MOTION FOR STAY OF AMENDMENTS FOR SMALL AND ADDITIONAL ISSUES
EXEMPTIONS UNDER THE SECURITIES ACT (REGULATION A) BY MONICA J.
LINDEEN, MONTANA STATE AUDITOR, EX OFFICIO COMMISSIONER OF
SECURITIES AND INSURANCE**

Monica J. Lindeen, Montana State Auditor, ex officio Commissioner of Securities and Insurance (“Petitioner”), hereby requests that the Securities and Exchange Commission stay its newly adopted final rule known as “Regulation A+,” including the June 19, 2015, effective date. Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), 80 Fed. Reg. 21,806 (Apr. 20, 2015). Petitioner requests this stay pending final resolution of the petitions for review challenging the final rule filed on May 22, 2015, in *Lindeen v. S.E.C.*, No. 15-1149 (D.C. Cir. filed May 22, 2015), and *Galvin v. S.E.C.*, No. 15-1150 (D.C. Cir. filed May 22, 2015) (cases consolidated May 27, 2015). Petitioner seeks a stay of the final rule in its entirety and for the pendency of the litigation.

An answer to this motion is respectfully requested by Monday, June 15, 2015.



Dated June 5, 2015

Respectfully submitted,



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**BRIEF IN SUPPORT OF MOTION FOR STAY OF AMENDMENTS FOR SMALL AND
ADDITIONAL ISSUES EXEMPTIONS UNDER THE SECURITIES ACT
(REGULATION A) BY MONICA J. LINDEEN, MONTANA STATE AUDITOR, EX
OFFICIO COMMISSIONER OF SECURITIES AND INSURANCE**



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INTRODUCTION

On March 25, 2015, the Securities and Exchange Commission (“Commission”) published the final rule amending Regulation A. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21,806 (Apr. 20, 2015) (“Final Rule”). The Final Rule establishes a two-tiered securities offering structure which, in part, preempts state securities registration requirements. The Commission also adopted a definition of “qualified purchaser” devoid of a substantive qualification requirement and eliminated the requirement that issuers pre-file “testing the waters” materials. *Id.*, 80 Fed. Reg. at 21, 842, 858. State securities administrators in Montana and Massachusetts have filed petitions for review in the United States Court of Appeals, District of Columbia Circuit, challenging the final rules. *Lindeen v. S.E.C.*, No. 15-1149 (D.C. Cir. filed May 22, 2015); *Galvin v. S.E.C.*, No. 15-1150 (D.C. Cir. filed May 22, 2015) (cases consolidated May 27, 2015). With a looming implementation date of June 19, 2015, Petitioner requests a stay to forestall market uncertainty and potential harm to consumers.

Implementation of drastic Regulation A modifications during pending litigation would generate significant uncertainty for issuers and the public at large. Issuers would likely abstain from Regulation A offerings altogether, stymying the very capital formation the new rule seeks to promote. Potentially premature implementation would also generate pitfalls for issuers choosing to prepare offerings under the new rule, exposing them to possible additional expense and wasted effort. The rule’s deviations from stringent investor protection standards also militate against immediate implementation. The potential for harm in immediate implementation necessitates the Commission’s stay of the new rule pending resolution of the petitions for review.

DISCUSSION

The Commission has broad discretion under the Administrative Procedure Act (APA) to stay implementation of a rule or other action when it “finds that justice so requires[.]” 5 U.S.C. § 705 (2012). Traditionally, the Commission has applied a four-factor analysis for evaluating whether to grant a stay:

1. Whether there is a strong likelihood that a party will succeed on the merits in a proceeding . . . (or, if the other factors strongly favor a stay, that there is a substantial case on the merits);
2. Whether, without a stay, a party will suffer imminent, irreparable injury;
3. Whether there will be substantial harm to any person if the stay were granted; and
4. Whether the issuance of a stay would likely serve the public interest.

Order Denying Stay, Exchange Act Release No. 68,197, at 5, 2012 SEC LEXIS 3470 (Nov. 8, 2012).

The APA does not require this analysis, and the Commission need not apply it in this instance. Similarly, when the Commission does apply the four-factor test, it does not do so mechanically without regard to the nuances of the specific motion before it. *Id.* (“If the arguments for one factor are particularly strong, a stay may be appropriate even if the arguments on the other factors are less convincing.”); *Order Preliminarily Considering Whether to Issue Stay Sua Sponte and Establishing Guidelines for Seeking Stay Applications*, Exchange Act Release No. 33,870, at 3, 1994 LEXIS 1025 (Apr. 7, 1994) (“The evaluation of these factors will vary with the equities and circumstances of each case.”). While the Commission may stay the Final Rule by simply finding that “justice so requires,” a stay is necessary even if evaluated under this more stringent test for relief under all four factors, as outlined below.

1. Petitioner Is Likely to Prevail in the Petition for Review.

Petitioner asserts two bases under which there exists a strong likelihood that she will prevail in her appeal of the Final Rule. First, the Commission has adopted an impermissible statutory interpretation. Second, the Commission insufficiently analyzed the costs and benefits of the Final Rule as it relates to the protection of investors. Each of these provides an independent and adequate basis for invalidation of the Final Rule.

A. The Commission has adopted an impermissible interpretation of the JOBS Act.

Petitioner challenges the Final Rule's expansive definition of "qualified purchaser" as contrary to the plain meaning of the statute. Title IV of the Jumpstart Our Business Startups Act of 2012 (JOBS Act) added Section 3(b)(2) to the Securities Act of 1933 (Securities Act). JOBS Act of 2012, Pub. L. 112-106, § 401, 126 Stat. 306, 324 (codified as 15 U.S.C. § 77c(b)(2) (2012)). This provision increased the annual offering limits for 3(b)(2) securities to \$50 million. *Id.* The JOBS Act also added Section 18(b)(4)(D) to the Securities Act, exempting 3(b)(2) securities from state "blue sky" laws if the securities are "(i) offered or sold on a national securities exchange; or (ii) offered or sold to a qualified purchaser, as defined by the Commission. . . ." *Id.* at § 401, 126 Stat. at 325 (codified as 15 U.S.C. § 77r(b)(4)(D)). The new rule defines "qualified purchaser" as "any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A." Amendments, 80 Fed. Reg. at 21,899 (to be codified at 17 C.F.R. § 230.256).

The definition of "qualified purchaser" adopted in the Final Rule conflicts with the unambiguous language of the JOBS Act. In the ordinary sense of the word, "qualified" means "having the necessary skill, experience, or knowledge to do a particular job or activity." Merriam Webster Dictionary, <http://www.merriam-webster.com/dictionary/qualified> (last visited

June 4, 2015). In the statute, “qualified” modifies “purchaser.” Thus, Congress intended that a Regulation A purchaser have “the necessary skill, experience, or knowledge,” or some other “qualifying” attributes such as minimum income or net worth.

This interpretation accords with legislative history of the National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (“NSMIA”). NSMIA codified Section 18(b)(3) of the Securities Act of 1933, which authorized the Commission to define “qualified purchaser.” *Id.* at § 18, 110 Stat. at 3418 (codified as 15 U.S.C. § 77r(b)(3) (1996)). Congress’ discussion of this provision repeatedly reflected an understanding that the “qualified purchaser” definition was to reflect the characteristics of the individual investor, including wealth and sophistication. *See* H.R. Rep. 104-622, at 31 (1996) (Conf. Rep.); S. Rep. 104-293, at 15 (1996).

The Commission’s “qualified purchaser” definition is an impermissible interpretation of the statute. The seminal case *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) establishes the standards for agency interpretation of a statute. The first factor requires that “[When] Congress has directly spoken to the precise question at issue . . . that is the end of the matter . . . the agency [] must give effect to the unambiguously expressed intent of Congress.” *Chevron*, 467 U.S. at 842-43. Congress unambiguously intended that a Regulation A purchaser possess specific sophistication, wealth, or other attributes. However, the Final Rule defines “qualified purchaser” based not upon such attributes, but solely upon the purchaser’s participation in a Tier 2 offering.

The Commission has pointed out that all Tier 2 participants either must (1) be accredited investors, or (2) limit their investment to a maximum of 10% of their annual income or net worth, whichever is greater. Amendments, 80 Fed. Reg. at 21,858. Notably, the second

restriction is of little substance, as the investors may self-certify that they adhered to the investment limitations. *Id.*, 80 Fed. Reg. at 21, 878. At any rate, these “requirements” are not sufficient to ensure that a purchaser is “qualified” in any way. Under the second option, any investor, regardless of skill, experience, knowledge, net worth, or any other characteristic, may participate in a Tier 2 Regulation A offering. Thus, the Final Rule permits investment by persons regardless of “qualification” – contrary to the unambiguous intent of Congress.

Even if the statutory language is ambiguous, the Commission’s interpretation is nonetheless unreasonable in light of express Congressional intent to avoid blanket preemption of current state regulatory laws. The second *Chevron* factor requires an agency’s interpretation of an ambiguous statute to be “based on a permissible construction of the statute. . . . [A] court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.” *Chevron*, 467 U.S. at 843-44. By exempting Regulation A Tier 2 securities from state “blue sky” laws, the Commission has imposed broad preemption over state registration statutes. This approach is unreasonable because it conflicts with Congressional intent. While Congress considered broadly preempting state securities laws, it explicitly rejected such an approach. *See, e.g.*, 157 Cong. Rec. 166, H7231 (2011) (discussing amendment removing “blue sky” preemption); Comment Letter of North American Securities Administrators Association, Inc. (NASAA), 4-6 (March 24, 2014). By adopting a definition of qualified purchaser that results in blanket state preemption, the Commission applied an impermissible interpretation of the JOBS Act.

B. The Commission insufficiently analyzed the costs and benefits of the Final Rule as it relates to the protection of investors.

An agency action is unlawful and must be set aside if it is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A) (2012). In promulgating an administrative rule, the Commission must consider “whether an action is necessary or appropriate in the public interest,” including an evaluation of “protection of investors, [and] whether the action will promote efficiency, competition, and capital formation.” 15 U.S.C. §§ 77b(b), 78c(f) (2012). A failure to consider each of these factors when adopting a rule renders the rule arbitrary and capricious. *See, e.g., Business Roundtable v. S.E.C.*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); *Chamber of Commerce of the U.S. v. S.E.C.*, 412 F.3d 133, 140 (D.C. Cir. 2005); *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004).

The Final Rule is invalid because the Commission failed to fully consider the protection of investors prior to its adoption. Specifically, the Commission did not adequately analyze the effects upon investors of: (1) broad preemption of state “blue sky” laws; and (2) eliminating the filing requirements for “testing the waters” materials. Several commenters to the proposed rule pointed out that the Commission’s “cost-benefit analysis of preemption was inadequate because it largely ignored investor protections, the benefits of state regulation, perceived resource constraints at the Commission, and preemption’s impact on investor confidence in the markets.” Amendments, 80 Fed. Reg. 21,857 (citations to rule comments omitted).

However, the Final Rule only briefly addressed Tier 2 investor protection. *Id.*, 80 Fed. Reg. at 21,887. The Commission performed minimal substantive analysis. Instead, it largely reiterated the contents of the Final Rule in support of its contention that “amended Regulation A

provides substantial protections to purchasers in Tier 2 offerings.” *Id.* The Commission has failed to “disclose a reasoned basis” for this conclusion as required under law. *Am. Equity Inv. Life Ins. Co. v. S.E.C.*, 613 F.3d 166, 177 (D.C. Cir. 2010). The Commission’s Final Rule likewise lacks sufficient review of the effect upon investor protection of not requiring pre-filing of “testing the waters” materials. Amendments, 80 Fed. Reg. 21,842-43. Given these deficiencies, the Commission performed an inadequate analysis of the costs and benefits of the rule to investor protection, rendering its rule arbitrary and capricious.

2. A Party Would Suffer Imminent, Irreparable Injury If the Commission Implements the Rule.

The State of Montana has a vested interest in protecting its consumers from harm, and in the smooth transaction of business and securities within its borders. Implementation of the Final Rule would cause injury to Montana issuers and consumers alike. Such an implementation in the midst of the pending litigation would create confusion in the marketplace. Issuers would be faced with following the new Regulation A process and run the risk of its eventual invalidation, pursuing an alternative means of capital formation, or simply waiting for the conclusion of the litigation. The uncertainty would force such issuers to choose between undesirable alternatives and create an uneven playing field in which more cautious issuers are penalized for attempting vigorous regulatory compliance.

Multiple rule commenters to the proposed rule accurately predicted that implementation of the Final Rule could result in litigation; they anticipated implementation “will have a chilling effect on the actual use of Regulation A moving forward.” Comment Letter of NASAA at 8; *see also* Comment Letter of Mike Liles, 3 (Jan. 17, 2014). While the goal of the new rule is to facilitate capital formation, immediate implementation could lead to the contrary result of issuers

abstaining from Regulation A offerings pending resolution of the litigation. Such abstention would result in the very harm the Commission is trying to prevent – missed capital formation opportunities.

Moreover, if the D.C. Circuit strikes the Final Rule, issuers acting in reliance upon the Commission’s implementation date would face significant unintended consequences. Issuers who are in the process of preparing offerings at the time the Final Rule is struck down would be forced to sacrifice much of their recently-expended time and efforts, and belatedly pursue an alternative capital formation scheme. Those issuers would absorb the wasted expense and effort of preparing the Regulation A offering, only to then incur more costs in implementing another process.

For those same issuers, invalidation of the Final Rule would disrupt the timing of the offering. Issuers carefully time offerings according to the needs and opportunities of the issuer, as well as the availability and interest of capital investors. A small- to medium-sized issuer may have only one window to achieve a successful offering. A delay in the offering would result in a lost capital formation opportunity that may never reappear. Contrary to the Final Rule’s stated goal of promoting capital formation, its immediate implementation would result in imminent irreparable harm in the form of lost capital opportunities as well as additional costs and duplicative administrative burdens.

Likewise, immediate implementation would expose unsophisticated and unwary consumers to irreparable harm. Under the rule’s deficient “qualified purchaser” definition, unsophisticated and vulnerable Tier 2 investors could invest in unsuitable offerings, resulting in exposure to substantial financial harm. The threat of consumer harm is magnified by the Final Rule’s permission of unvetted “testing the waters” materials. Amendments, 80 Fed. Reg.

21,842. The unsophistication of these newly “qualified” investors renders them more susceptible to unregulated misinformation disseminated in such materials, and less likely to verify such information later in the issuing process. Staying the Final Rule would prevent imminent and irreparable harm by preventing uninformed investors from participating in unsuitable offerings during the pendency of the litigation.

3. No Substantial Harm Would Result from the Stay, and its Imposition Would Further the Public Interest.

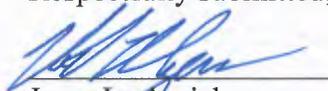
Imposition of the stay would not result in substantial harm to issuers, investors, or any other party. In fact, granting the stay would not prevent offerings from occurring. Regulation A has existed in some form for decades without the provisions contained in the Final Rule, and maintenance of the status quo would not have a significant deleterious impact upon market participants. During the stay, issuers would still have the same capital formation opportunities historically available to them. Imposition of a stay would provide certainty in the marketplace and perpetuate long-standing consumer protections until the litigation concludes. Although criticized by many, Regulation A in its current form remains a viable capital formation tool for some issuers. For those seeking over \$5 million, staying the rule would encourage them to pursue capital immediately under the methods currently available to them. Lastly, a stay would protect unsophisticated investors characterized as “qualified” under the new rule. Thus, it is in the public interest to stay the rule until the Court resolves the current regulatory uncertainty resulting from the litigation.

CONCLUSION

For the foregoing reasons, Petitioner respectfully requests that the Commission stay the implementation of the Final Rule until resolution of the petitions for review before the Court of Appeals, District of Columbia Circuit.

Dated June 5, 2015

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