

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9808 / June 16, 2015

In the Matter of)	
)	
MONICA J. LINDEEN, MONTANA STATE AUDITOR,)	ORDER
<i>EX OFFICIO</i> COMMISSIONER OF SECURITIES AND)	DENYING STAY
INSURANCE’S MOTION FOR STAY OF THE)	
AMENDMENTS FOR SMALL AND ADDITIONAL ISSUES)	
EXEMPTIONS UNDER THE SECURITIES ACT)	
(REGULATION A))	

On June 5, 2015, Monica J. Lindeen, Montana State Auditor, *ex officio* Commissioner of Securities and Insurance, filed a motion for a stay of the Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), which are scheduled to become effective on June 19, 2015.¹ For the reasons discussed below, the motion is denied.

BACKGROUND

On March 25, 2015, the Commission unanimously adopted a final rule that made numerous amendments and revisions to Regulation A’s exemption from registration under the Securities Act. *Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A); Final Rule*, Rel. No. 33-9741, 80 Fed. Reg. 21806 (April 20, 2015) (Adopting Release). In adopting this rule, the Commission implemented Section 401 of the Jumpstart Our Business Startups Act (JOBS Act), which Congress enacted in 2012. Section 401 of the JOBS Act amended the Securities Act by mandating that the Commission adopt rules exempting from registration offerings of up to \$50 million within a 12-month period—as described in Section 3(b)(2) of the Securities Act. Congress specified certain terms and conditions to be included and authorized the Commission to

¹ Along with her motion (Stay Mot.), Lindeen filed a supporting brief (Stay Br.).

adopt additional requirements as necessary in the public interest and for the protection of investors.

Congress also provided that certain offers and sales of Section 3(b)(2) securities issued pursuant to amended Regulation A would be “covered securities” for purposes of the National Securities Markets Improvement Act of 1996 (NSMIA). NSMIA fundamentally altered the securities regulation regime in the United States through Section 18(a). That provision preempted certain state laws related to the registration and qualification of “covered securities” while preserving state antifraud and filing laws. NSMIA also added Section 18(b)(3), which provided that “[a] security is a covered security with respect to the offer and sale of the security to qualified purchasers, as defined by the Commission by rule,” and authorized the Commission to “define the term ‘qualified purchaser’ differently with respect to different categories of securities, consistent with the public interest and the protection of investors.” 15 U.S.C. 77r(b)(3).

The JOBS Act linked the offer and sale of certain exempt securities to the definition of “qualified purchaser”—and the preemptive force that definition carries. Congress did this by adding Section 18(b)(4)(D), which states that Section 3(b)(2) securities are covered securities if they are “(i) offered or sold on a national securities exchange” or “(ii) offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale.” 15 U.S.C. 77r(b)(4)(D)(i)–(ii).

Implementing the JOBS Act mandate, the Commission adopted a final rule revising Regulation A. The Commission expanded Regulation A, in accordance with Congress’s directive, by creating two tiers of offerings: Tier 1 offerings of up to \$20 million and Tier 2 offerings up to \$50 million. While all Regulation A offerings are subject to certain basic requirements, such as issuer eligibility and “bad actor” disqualification, there are significant additional requirements applicable only to Tier 2 offerings. There are restrictions on who can purchase securities sold in Tier 2 offerings, which impose additional requirements on issuers, such as providing audited financial statements and complying with ongoing reporting obligations. *Adopting Release*, 80 Fed. Reg. at 21807.

In light of the significant investor protections built into the framework for Tier 2 offerings, the Commission defined “qualified purchaser” by stating that “[f]or purposes of Section 18(b)(3) of the Securities Act, a ‘qualified purchaser’ means any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A.” 80 Fed. Reg. at 21899. The result of defining

“qualified purchaser” in this fashion is the limited preemption of state laws envisioned by NSMIA for Tier 2 offerings. The Commission’s revisions to Regulation A go into effect on June 19, 2015.

On May 22, 2015, Monica J. Lindeen, in her capacity as the Montana State Auditor and Commissioner of Securities and Insurance, filed a petition for review in the United States Court of Appeals for the District of Columbia Circuit challenging the rule. Case No. 15-1149 (D.C. Cir. May 22, 2015).² On June 5, 2015, Lindeen requested that the Commission stay the effective date of the amendments to Regulation A pending the outcome of the litigation. Lindeen “seeks a stay of the final rule in its entirety and for the pendency of the litigation.” Stay Mot. at 1.

Lindeen contends that a stay is warranted because Montana has a strong likelihood of success on the merits of its challenge. More specifically, Lindeen argues that the D.C. Circuit will find that the Commission’s definition of “qualified purchaser” was impermissible and that the Commission did not adequately analyze the effects upon investors of preempting some state laws for Tier 2 offerings. Stay Br. at 3–7. Lindeen further argues that denying a stay will expose Montana issuers and “unsophisticated and unwary consumers to irreparable harm.” *Id.* at 7–8. Finally, Lindeen asserts that granting a stay will not cause harm because “issuers would still have the same capital formation opportunities historically available to them” under Regulation A in its current form. *Id.* at 9.

DISCUSSION

The Commission has the discretion to stay a regulation pending judicial review if “it finds that justice so requires.” 5 U.S.C. 705; *cf.* Section 25(c)(2) of the Exchange Act, 15 U.S.C. § 78y(c)(2). In exercising that discretion, the Commission is guided by a four-factor test that courts use to determine whether a stay during litigation is appropriate:

1. Whether there is a strong likelihood of success on the merits;
2. whether, absent a stay, a party will suffer imminent, irreparable injury;
3. whether granting a stay will cause substantial harm to any person; and

² William F. Galvin, Secretary of the Commonwealth of Massachusetts, also filed a petition for review in the D.C. Circuit challenging the amendments to Regulation A. *See William F. Galvin, Sec’y of the Commonwealth of Mass. v. SEC*, Case No. 15-1150 (D.C. Cir. May 22, 2015). Secretary Galvin did not seek to stay the rule.

4. whether the issuance of a stay serves the public interest.

See William Timpinaro et al., Rel. No. 34-29927, 1991 WL 288326 *2 (Nov. 12, 1991). As the moving party, Montana bears the burden of showing that all four factors, taken together, favor a stay. *Am. Petroleum Inst. et al.*, Rel. No. 34-68197, 2012 WL 5462858 *2 (Nov. 8, 2012). If a movant makes no showing of a likelihood of success on the merits or no showing of imminent, irreparable harm, a stay is not merited. *Sherley v. Sebelius*, 644 F.3d 388, 392–93 (D.C. Cir. 2011); *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 22–23 (2008); *see also Am. Petroleum Inst. et al.*, 2012 WL 5462858 *3 (“[A] party seeking a stay *must* demonstrate some imminent, irreparable harm. . . . Failure to do so alone is a sufficient basis to deny a stay.”)

I. Lindeen has not shown a strong likelihood of success on the merits.

We find that Lindeen has not demonstrated a strong likelihood of success on the merits of her claim that the Commission’s definition of “qualified purchaser” is “contrary to the plain meaning” of the JOBS Act and NSMIA or on the merits of her claim that “the Commission insufficiently analyzed the costs and benefits of the Final Rule as it relates to the protection of investors.” Stay Br. at 3.

A. Lindeen has not demonstrated a strong likelihood of success on her claim that the Commission’s definition is contrary to the statute.

We do not agree that the D.C. Circuit is likely to conclude that the Commission’s definition of “qualified purchaser” is contrary to the JOBS Act and NSMIA. The rule as adopted defines a “qualified purchaser” as “any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A.” 80 Fed. at 21899. This definition incorporates the investor protections applicable to all Regulation A offerings and the additional requirements specific to Tier 2 offerings, including limitations on who can purchase securities sold in such offerings. *Id.* at 21807–09.

The text of the statute supports the Commission’s exercise of its definitional authority and undermines Lindeen’s contention that the definition is contrary to Congress’s intent that investors in revised Regulation A offerings “have ‘the necessary skill, experience, or knowledge,’ or some other ‘qualifying’ attributes.” Stay Br. at 4. Section 18(b)(3) of the Securities Act, which Congress added in 1996 as part of NSMIA’s targeted preemption of state law, gives the Commission

express and broad authority to define “qualified purchaser” by rule. 15 U.S.C. 77r(b)(3). As we pointed out in our Adopting Release, the statutory text did not “prescribe specific criteria that the Commission must consider in determining, or the manner in which it must determine, a purchaser to be ‘qualified.’” 80 Fed. Reg. at 21859. Rather, by expressly authorizing the Commission to “define the term ‘qualified purchaser’ differently with respect to different categories of securities,” 15 U.S.C. 77r(b)(3), Congress permitted the Commission “to adopt a qualified purchaser definition that is . . . tailored to reflect the characteristics of the particular type of issuer or transaction.” 80 Fed. Reg. at 21859. The JOBS Act reinforced the Commission’s definitional authority by providing that a Section 3(b)(2) security “is a covered security” if such a security is “offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) *with respect to that purchase or sale.*” 15 U.S.C. 78r(b)(4)(D)(ii) (emphasis added).

When Congress expressly delegates definitional authority in this fashion, the deference afforded to an agency is at its zenith. The Commission’s judgment in defining a term is given “more than mere deference or weight”—it is given “controlling weight” unless it is “arbitrary, capricious, or manifestly contrary to the statute.” *United States v. O’Hagan*, 521 U.S. 642, 673 (1997), quoting *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843–44 (1984) (“If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.”). The D.C. Circuit is likely to conclude that the Commission’s definition of “qualified purchaser” is controlling under that precedent particularly when the Commission provided a detailed and reasoned explanation of why it was adopting that definition in light of the purposes of the JOBS Act and the protections afforded to investors by the limitations and requirements for Tier 2 offerings.

Lindeen focuses on what she describes as the “ordinary meaning” of “qualified,” as defined in a dictionary, but that argument is unlikely to prevail. Stay Br. at 3–4. The D.C. Circuit has made clear that when Congress expressly delegates authority to define a particular word or term, “[t]hat provision necessarily suggests that Congress did *not* intend the word to be applied in its plain meaning sense.” *Women Involved in Farm Economics v. USDA*, 876 F.2d 994, 1000 (D.C. Cir. 1989). Moreover, the Commission’s definition is consistent with the plain meaning of “qualified” because that term, in the context of Section 18(b)(3), refers to the Commission’s ability to determine, by rule, that the attributes of a category of securities are consistent “with the public interest and the

protection of investors,” and are therefore sufficient to justify status as a “covered security.” 15 U.S.C. 78r(b)(3).

It is likely that the D.C. Circuit will conclude that the Commission’s definition is consistent with this statutory language, which places the lone constraint on the Commission’s definitional authority. The Adopting Release described in depth how its definition serves the public interest given that the JOBS Act required us “to consider the definition of qualified purchaser specifically within the context of transactions under the new Section 3(b)(2) exemption,” which was intended to facilitate capital formation for smaller businesses and provide more investment opportunities for the public. 80 Fed. Reg. at 21860. Moreover, in defining “qualified purchaser,” we “considered not only the mandatory features of Section 3(b)(2), but also the many discretionary features contained in our final rules. These features include the requirement that purchasers in Tier 2 offerings be limited to accredited investors or persons otherwise subject to specified investment limitations,” namely a requirement that the purchase price in a Tier 2 offering not be more than 10% of the greater of a purchaser’s annual income or net worth. 80 Fed. Reg. at 21859. The definition is consistent with the statute because it appropriately and reasonably balances the capital formation imperative imposed by Congress with numerous provisions designed to protect investors. *Id.* at 21860.

Lindeen further contends that the “qualified purchaser” definition is “unreasonable in light of express Congressional intent to avoid blanket preemption of current state regulatory laws.” Stay Br. at 5. We think the D.C. Circuit is unlikely to credit this argument because it rests on two false premises. Contrary to what Lindeen argues: (1) the definition of “qualified purchaser” does not produce a “blanket preemption” of state laws; and (2) the JOBS Act demonstrates that Congress intended a limited preemption of state laws with regard to offerings under a revised Regulation A.

The preemption that results from the definition of “qualified purchaser” is more limited than Montana suggests. We had originally proposed a definition that would preempt state registration and qualification requirements for all offerees in Tier 1 and Tier 2 offerings, and for all purchasers in Tier 2 offerings. 80 Fed. Reg. at 21856–57. But the definition we adopted is narrower and preempts state registration and qualifications only for Tier 2 offerings. *Id.* at 21858, 21899. Moreover, preemption under Section 18 of the Securities Act for “covered securities” preserves substantial state powers: it does not affect antifraud laws or

laws requiring filing of documents and payment of fees. *Id.* at 21860; *see also* 15 U.S.C. 78r(c).

This limited preemption is consistent with—and expressly authorized by—the JOBS Act. Congress amended Section 18(b)(4) of the Securities Act, which lists “covered securities” for which the limited preemption in Section 18(a) takes hold, by adding a new subsection (D). This new subsection deemed Section 3(b)(2) securities—those that would be sold under expanded Regulation A—as “covered securities” if they are “offered or sold on a national securities exchange” or “offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale.” By authorizing the Commission to define “qualified purchaser” for the purposes of Regulation A offerings, and thereby bring some Regulation A securities into the category of “covered securities,” Congress expressly authorized the limited preemption of state law under Section 18(a)(1)(A). Lindeen’s contention that such preemption “conflicts with Congressional intent” cannot be reconciled with the text of the JOBS Act.

B. Lindeen has not demonstrated a strong likelihood of success on the merits of her claim that the Commission failed to adequately analyze the economic consequences of the rule as it relates to investor protection.

Given the robust analysis of the economic consequences of the rule in the Adopting Release, we believe that the D.C. Circuit is likely to reject Lindeen’s contention that the Commission “performed minimal substantive analysis” of the rule’s effects upon investors. *Stay Br.* at 6. Under Section 2(b) of the Securities Act, 15 U.S.C. 77b(b), when the Commission is engaged in rulemaking and is required to consider whether the action is in the public interest, the Commission must “also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.” But to satisfy that statutory obligation, the Commission need not “measure the immeasurable” or “conduct a ‘rigorous, quantitative economic analysis’ unless the statute explicitly directs it to do so.” *Nat’l Assn. of Mfr. v. SEC*, 748 F.3d 359, 369 (D.C. Cir. 2014), *quoting Inv. Co. Inst. v. CFTC*, 720 F.3d 370, 379 (D.C. Cir. 2013), and *overruled in part on other grounds, Am. Meat Inst. v. USDA*, 760 F.3d 18, 22–23 (D.C. Cir. 2014) (en banc). And if a rule is mandatory, that will factor into the D.C. Circuit’s assessment of whether the Commission’s economic analysis was sufficient. *Id.* at 369–70.

Particularly in the context of this rulemaking, which Congress mandated in a statute that emphasized the facilitation of capital formation, the D.C. Circuit is unlikely to find that the Commission’s economic analysis is deficient on the ground Lindeen urges. Congress enacted JOBS Act Section 401 “against a background of public commentary suggesting that Regulation A . . . should be expanded and updated to make it more useful to small companies,” and it required us “to engage in rulemaking that is meant to increase the use of Regulation A, thereby helping to make capital available to small companies.” *Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act*, 79 Fed. Reg. 3626, 3927 (Jan. 23, 2014) (Proposing Release).

With this context in mind, the release thoroughly analyzed the economic effects—including costs, benefits, and impacts on efficiency, competition, and capital formation—of state registration and qualification laws for both the existing and revised forms of Regulation A. 80 Fed. Reg. at 21886-88. The Adopting Release discussed how the cost of complying with a multitude of state-law requirements created a “significant disincentive” and “was one of the factors that appeared to have influenced the infrequent use of Regulation A by small businesses.” *Id.* at 21886. And the economic analysis described how by eliminating these costs, the limited preemption of state law for Tier 2 offerings would benefit issuers by fostering increased use of Regulation A, which would facilitate capital formation, helping small businesses and the economy overall. *Id.*

The Commission did not ignore the effect of preemption on investor protection. The Adopting Release acknowledged that preemption may impose a cost through the loss of “additional investor protection benefits arising from the localized knowledge and resources of state regulators.” 80 Fed. Reg. at 21886–87. And the Adopting Release explained that “[s]everal factors could mitigate these potential impacts,” including the states’ retained authority to investigate and prosecute fraud, as well as the numerous disclosure and investment limitation provisions built into the rules for Tier 2 offerings. *Id.* at 21887. Ultimately, the rule we adopted struck a balance “between mitigating cost and time demands on issuers and providing investor protections.” *Id.* at 21888. This balancing was informed by Congress’s objective to facilitate capital formation through Regulation A when it adopted the JOBS Act. *Id.*

Lindeen’s failure to identify specific defects in the economic analysis further supports our conclusion that her challenge is unlikely to succeed. The assertion that we “performed minimal substantive analysis” is belied by the depth of the analysis in the Adopting Release. Stay Br. at 6. And if “substantive” refers to a

lack of quantification of the costs to investors, Lindeen is criticizing the Commission for something it is not required to do—“measure the immeasurable.” *Nat’l Ass’n. of Mfr.*, 784 F.3d at 369 (internal quotation marks omitted). As the Commission explained in the Adopting Release, it could not quantify those costs because it was “unable to predict how the amendments to Regulation A will affect the incidence of fraud that may arise in Regulation A offerings.” 80 Fed. Reg. at 21887.

II. Lindeen has failed to show irreparable harm if the rule is not stayed.

Lindeen has not provided support for her contention that “[i]mplementation of the Final Rule” during the pendency of the litigation “would cause injury to Montana issuers and consumers alike” by creating “confusion in the marketplace” and exposing Tier 2 investors to “substantial financial harm.” Stay Br. at 7–8. “To warrant a stay, ‘the injury must be both certain and great; it must be actual and not theoretical.’” *Donald L. Koch and Koch Asset Mgmt, LLC*, Rel No. 34-72443, 2014 WL 2800778 *2 (June 20, 2014) (quoting *Wisc. Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985)). A movant must “demonstrate that irreparable injury is *likely*” in the absence of a stay, and not merely “a possibility.” *Winter*, 555 U.S. at 7 (emphasis in original). Linden has not cleared this crucial hurdle.

The potential harm to Montana issuers that Lindeen identifies is hypothetical. Lindeen argues that implementing the rule during the litigation will discourage capital formation because risk-averse issuers will not proceed with Regulation A offerings if there is a possibility that the D.C. Circuit will vacate the rule. Stay Br. at 7–8. While Lindeen is correct that her lawsuit *has* created uncertainty, issuer forbearance from Regulation A is not an inevitable consequence of that uncertainty. It is impossible to know what issuers will do while this litigation is pending; some issuers may refrain from Tier 2 offerings due to the litigation initiated by Montana, but others may choose to engage in such offerings after balancing the benefits of obtaining capital against the risks of potential disruption to the offering process. Such “[b]are allegations of what is likely to occur are of no value” in terms of providing the necessary “proof indicating that the harm is certain to occur in the near future.” *Wisc. Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985).

As to investor harm, we question the bases for Lindeen’s assertion that “immediate implementation would expose unsophisticated and unwary consumers to irreparable harm.” Stay Br. at 8. To begin with, it is not correct that investors in Tier 2 offerings are stripped of adequate protection. Even with preemption of state

registration and qualification requirements, Tier 2 offerings are subject to regulation by the Commission, they come with significant disclosure requirements, and they are subject to important limits—including limits on which investors can purchase. These requirements will offer robust investor protections once the rule goes into effect. Moreover, several aspects of state law designed to protect investors, particularly state antifraud provisions, will remain unaffected once the rule goes into effect. Ultimately, Lindeen’s assertion that the rule will expose investors “to substantial financial harm” is inherently speculative because it is impossible “to predict how the amendments to Regulation A will affect the incidence of fraud that may arise in Regulation A offerings.” 80 Fed. Reg. at 21887. Given that uncertainty, there is no basis for crediting Lindeen’s contention that there will be irreparable harm if we deny the stay.

III. The public interest is not served by granting a stay because doing so would cause harm and contravene Congress’s will.

We disagree with Lindeen’s contention that a stay “would not result in substantial harm to issuers, investors, or any other party.” Stay Br. at 9. If the rule is stayed, issuers will be deprived of the ability to raise capital through the expansion of Regulation A that Congress ordered in the JOBS Act. Indeed, if the entire rule is stayed, issuers will be precluded from making Tier 1 offerings, as well as Tier 2 offerings. This harms not only the small businesses that are most likely to use Regulation A, but also the economy more broadly. While Lindeen implies that issuers should be protected from “missed capital formation opportunities” through a stay, we believe that issuers should be given the choice of how to proceed during the litigation. *Id.* at 8.

We cannot conclude, as Lindeen urges, that staying the rule causes no harm because “Regulation A in its current form remains a viable capital formation tool for some issuers.” Stay Br. at 9. Congress enacted the JOBS Act—and mandated that the Commission amend Regulation A—precisely because Regulation A was *not* a viable tool for capital formation, as demonstrated by the paucity of qualified offerings under Regulation A in recent years. *Factors that May Affect Trends in Regulation A Offerings*, GAO–12–839 (July 2012), available at <http://www.gao.gov/assets/600/592113.pdf>.

Moreover, while Lindeen does not address the issue, we note that investors will also suffer harm from a stay because accredited investors and those who meet the investment limitations for Tier 2 offerings will be deprived of investment opportunities in securities offered and sold pursuant to revised Regulation A.

Providing investment opportunities was part of Congress’s objective in enacting the JOBS Act, and we do not join in Lindeen’s speculative assumption that Regulation A offerings will necessarily harm “unsophisticated investors.” Stay Br. at 9.

After balancing the possible harms of granting versus denying a stay, we find that it is in the public interest to deny the stay. In reaching this conclusion, we are heavily influenced by the fact that Congress directed us to amend Regulation A because it concluded that the existing regime was not working as intended. *Proposing Release*, 79 Fed. Reg. at 3927; *see also* H.R. Rep. No. 112-206, at 4 (2011) (“Amending Regulation A to make it viable for small companies to access capital will permit greater investment in these companies, resulting in economic growth and jobs”). To grant a stay now would thwart Congress’s goal of increasing capital formation opportunities because it would perpetuate a form of Regulation A that Congress judged inadequate and mandated that we improve.

CONCLUSION

Accordingly, Lindeen’s request for a stay of the amendments to Regulation A is denied.

By the Commission.

Brent Fields
Secretary