Securities Regulation Daily Wrap Up, TOP STORY—D.C. Cir.: Montana, Massachusetts detail objections to Regulation A+, (Aug. 26, 2015)

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By Mark S. Nelson, J.D.

Montana and Massachusetts securities regulators filed their opening substantive salvos in an effort to derail a key part of the SEC's new Regulation A. The two states object to how the Commission defined "qualified purchaser" and to federal preemption of Blue Sky laws that otherwise may apply to some Regulation A offerings. The regulators made their views known in a joint brief filed today (*Lindeen v. SEC*, August 26, 2015).

Regulation A+ and preemption. In March, the SEC adopted a framework for Regulation A offerings, popularly known as Regulation A+, as required by the Jumpstart Our Business Startups (JOBS) Act. The Commission's tweaks to the seldom-used Regulation A raised the annual offering limit for some securities offerings and, thus, brought to a close yet another chapter in the agency's efforts to finish its JOBS Act rulemakings.

New Regulation A divides exempt offerings into two tiers, each with different requirements. The Montana and Massachusetts securities regulators object to how the SEC designed Tier II. This tier governs offerings of up to $50 million and shares many basic requirements with Tier I offerings. (Tier I applies to offerings of up to $20 million).

But under Tier II, there are added duties regarding audited financials, periodic reporting, and limits on the amount of securities that can be bought by non-accredited investors (10 percent of annual income or net worth). Tier II also preempts state Blue Sky laws for "qualified purchasers," whom Securities Act Rule 256 defines as "any person" to whom securities are offered or sold under Tier II. Securities Act Section 18(b)(3) gives the Commission power to define "qualified purchasers" differently based on categories of securities.

Both the Montana and Massachusetts securities regulators petitioned the D.C. Circuit to review the validity of the Commission's rule. The Commission refused to stay its updated Regulation A just three days before its June 19 effective date.

Who can fend for self? The states' argument that the court should invalidate part of the SEC's new Regulation A in favor of their regulatory authority has both practical and philosophical elements. On the philosophical side, Montana and Massachusetts note that their regulations (first adopted in 1913 and 1921, respectively) came long before the federal government began to regulate securities in the 1930s, and that states' authority has become increasingly uniform under model rules at the same time that Congress periodically reworks federal securities laws to more clearly divide federal and state authorities.

But the states' also make a practical argument: they say the Commission erred by defining "qualified purchaser" too broadly in new Regulation A, instead of crafting a narrower definition that would exempt only those offerings where investors can fend for themselves (a point both philosophical and practical that is exemplified by the Supreme Court's *Ralston Purina* opinion).

Specifically, the states argue that defining "qualified purchaser" to mean "any person" in a Tier II offering disregards the Commissioner's earlier efforts to define the term to match the definition of "accredited investor" under Regulation D. Instead, the states argued that the Commission's latest Regulation A proposal mulled a range of "qualified purchaser" definitions before settling one that applied broadly to both Tier I and Tier II offerings.

The Commission's final rule, said the states, inexplicably shifted gears yet again in order to adopt a definition of "qualified purchaser" that dropped references to Tier I, but which applies broadly to Tier II. Ultimately, the states claim that the Commission failed to adequately limit its definition of "qualified purchaser," which by its terms required the commissioners to qualify who is a purchaser rather than to include on an unqualified basis "any person" in a Tier II offering.

The states said this violates *Chevron* step one because Congress intended for preemption to apply only to those who can fend for themselves without state regulations, such as accredited investors or others with sufficient wealth, income, and sophistication. Likewise, the states argue that the final rule fails *Chevron* step two because it is neither permissible nor reasoned.

Cost-benefit analysis. The states take the Commission to task for what they see as a “flawed” analysis of the costs and benefits of preempting Tier II offerings under Regulation A. According to Montana and Massachusetts, state laws policed by regulators with local knowledge could do more than the SEC to lessen the risk of fraud and its related costs. The states argue that the Commission’s discussion of the costs and benefits of its final rule are too speculative to survive judicial scrutiny.

The states also noted that the North American Securities Administrators Association, Inc. had argued forcefully against the SEC’s approach in a comment letter on the Commission’s proposed Regulation A. Separately, NASAA said it would prefer to regulate these offerings under its Coordinated Review Program.

The case is No. 15-1149.

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Companies: North American Securities Administrators Association, Inc.

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