ORAL ARGUMENT NOT YET SCHEDULED
No. 15-1149

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

MONICA J. LINDEEN, MONTANA STATE AUDITOR, EX OFFICIO MONTANA COMMISSIONER OF SECURITIES AND INSURANCE,

Petitioner,

v.

U.S. SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Consolidated with 15-1150

On Petition for Review of a Final Rule of the
U.S. Securities and Exchange Commission

BRIEF OF CURRENT AND FORMER MEMBERS OF CONGRESS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to D.C. Circuit Rules 28(a)(1) and 29(d), the undersigned counsel certifies as follows:

A. Parties and Amici

All parties, intervenors, and *amici* appearing in this Court are listed in the Brief for Petitioners and Brief for Respondent.

Amici are current and former members of the U.S. Congress: Representative Maxine Waters, Representative Stephen Lynch, Representative Keith Ellison, Representative Michael Capuano, Representative Carolyn Maloney, Representative Niki Tsongas, Senator Ed Markey, and former Representative Barney Frank.

B. Rulings Under Review

References to the rule at issue appear in the Brief for Petitioners.

C. Related Cases

Counsel is aware of no related cases currently pending in any other court.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

GLOSSARY

JOBS Act	Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012)
Regulation A	17 C.F.R. §§ 230.251-230.263
Regulation A Plus	Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Final Rule, 80 Fed. Reg. 21,806 (Apr. 20, 2015)
SEC	U.S. Securities and Exchange Commission

STATUTES AND REGULATIONS

All applicable statutes and regulations are contained in the Brief for the Petitioners.

AMICI CURIAE'S INTEREST, IDENTITY AND AUTHORITY TO FILE

Amici curiae are current and former members of the United States Congress who support Title IV of the Jumpstart Our Business Startups ("JOBS") Act of 2012, which was passed by Congress and signed into law on April 5, 2012. Pub. L. No. 112-106, 126 Stat. 306 (2012). *Amici* have an interest in this case because the final rule implementing Title IV preempts state regulatory oversight and does not effectuate Congressional intent. *Amici* are Representative Maxine Waters, Representative Stephen Lynch, Representative Keith Ellison, Representative Michael Capuano, Representative Carolyn Maloney, Representative Niki Tsongas, Senator Ed Markey, and former Representative Barney Frank. All parties have consented to the filing of this brief, consistent with Rule 29 of the Federal Rules of Appellate Procedure.

ARGUMENT

I. The authority to preempt state regulation lies with Congress.

The Supremacy Clause of the U.S. Constitution vests the authority to federally preempt state and local law exclusively with Congress. U.S. CONST. art. VI, cl. 2. Questions related to the exercise of this authority are among the most sensitive and important questions that Congress considers, especially when enacting major legislation, such as the JOBS Act. Notwithstanding clear Congressional intent to the contrary, the Securities and Exchange Commission

broadly preempted the states and the authority of the state securities regulators when promulgating the final rule implementing Title IV of the JOBS Act.

II. The SEC preempted state regulation under the Rule.

Congress passed Title IV of the JOBS Act to increase the amount an issuer may raise under Regulation A, 17 C.F.R. §§ 230.251-230.263 from $5 million to $50 million, thereby facilitating securities offerings for small and mid-sized companies by exempting such offerings from the registration requirements of the Securities Act of 1933. The final rule promulgated by the Commission, referred to as Regulation A Plus, created two tiers of offerings: offerings that do not exceed $20 million (Tier 1) and offerings that do not exceed $50 million (Tier 2). Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Final Rule, 80 Fed. Reg. 21,806, 21,858 (Apr. 20, 2015). Issuers of offerings of less than $20 million may elect either a Tier 1 or Tier 2 offering status. *Id*. at 21,808. Under Tier 2, investors must be accredited or limit their investment to 10 percent of their annual income or net worth. In determining whether an investor meets these income and net worth restrictions, the final rule allows issuers to rely on the investor's representations, without requiring actual verification or providing a meaningful standard to assure the accuracy of these representations. *Compare* 80 Fed. Reg. at 21,878 (allowing issuers to certify based on investor representations), *with* 17 C.F.R. § 230.506(c)(2)(ii) (requiring issuers

under Rule 506 of Regulation D to take reasonable steps to verify that purchasers of securities are accredited investors). State review and qualification of Tier 2 offerings are preempted. *Id.* at 21,858.

III. The SEC's decision to preempt state regulation was contrary to the intent of Congress.

It was not the intent of Congress to preempt state authority and the important investor protections that the state regulators provide. In fact, when considering the legislation that would eventually become Title IV of the JOBS Act, Congress debated at length and affirmatively rejected provisions that would have generally preempted the States' authority to review and qualify Regulation A Plus offerings. The House of Representatives voted on an overwhelmingly bipartisan basis, 421-1, to reject legislation that would have broadly preempted state authority to review and qualify Regulation A Plus securities sold to ordinary investors through a broker or dealer. 157 CONG. REC. H7236 (daily ed. Nov. 2, 2011). Instead, Congress opted to permit only a narrow, tailored preemption for securities sold to a small universe of sophisticated investors who are deemed to be "qualified purchasers" by the Commission and for securities that are listed on an exchange. Congress intended this new language to preserve state authority over Regulation A Plus offerings, when those securities are sold to retail investors or not subject to the heightened standards imposed by an exchange.

This limited preemption is rooted in Congress's recognition that state securities regulators are closest to the investing public and have extensive experience in overseeing smaller, regional offerings, such as those that will result from the implementation of Title IV of the JOBS Act. Congress's decision to rely on the "qualified purchaser" exemption to effectuate the intended narrow and targeted preemption assumed that the Commission would define and apply the term in a manner consistent with previous Congressional directives and legislative intent. Indeed, as previously recognized by the Commission in a 2001 release, the qualified purchaser exemption is "rooted in the belief that 'qualified' purchasers are sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary." Defining the Term "Qualified Purchaser" Under the Securities Act of 1933, 66 Fed. Reg. 66,839, 66,845 (Dec. 27, 2001) (citing H.R. REP. NO. 104-622, at 31 (1996); S. REP. NO. 104-293, at 15 (1996)). We also note that in its 2001 release, the Commission proposed that accredited investors would meet the sophistication requirements to be deemed a qualified purchaser. *Id.* at 40. However, in its final rule, the Commission inexplicably expanded the qualified purchaser definition to also include retail investors with modest investment constraints. 80 Fed. Reg. at 21,858.

As introduced in the House of Representatives, H.R. 1070, the Small Company Capital Formation Act of 2011, which ultimately became Title IV of

JOBS Act, did not contain any language preempting state securities regulators' review of Regulation A Plus offerings. H.R. 1070, 112th Cong. (as introduced, March 14, 2011). During consideration and markup of the bill before the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, Congressman Schweikert offered a substitute amendment providing for limited preemption of Regulation A Plus offerings from state securities laws. *Markup of H.R. 1070 – The Small Company Capital Formation Act of 2011; H.R. 1062 – The Burdensome Data Collection Relief Act; H.R. 33 – To amend the Securities Act of 1933 to allow church plans to invest in collective trusts; H.R. 940 – The United States Covered Bonds Act of 2011; H.R. 1082 – The Small Business Capital Access and Job Preservation Act; H.R. 1539 – The Asset-Backed Market Stabilization Act of 2011; and H.R. 1610 – The Business Risk Mitigation and Price Stabilization Act of 2011, Before the H. Comm.On Fin. Servs., Subcomm. on Capital Mkts. and Gov't Sponsored Enters.*, 112th Cong. (May 3, 2011) ("Markup of H.R. 1070") (Amendment offered by Rep. Schweikert). This substitute amendment, which was ultimately adopted, exempted Regulation A Plus offerings from state regulation in three instances: (1) securities offered or sold through a broker or dealer, (2) securities offered or sold on a national securities exchange, and (3) securities sold to a qualified purchaser. H.R. REP. NO. 112-206, at 2 (2011). During debate and markup of H.R. 1070, Congressman Frank offered an

amendment that removed the exemption for securities offered or sold through brokers or dealers. *Id*. at 4-5. Congressman Frank's amendment was defeated 20-26. *Id.*

According to the views of the Minority, filed after the debate on H.R. 1070:

> There was one contentious issue that arose during the markup that had nothing to do with the principle of an exemption limit increase, but instead with new language preempting state law. This language preempts state securities law for Regulation A securities offered or sold by a broker or dealer, creating a class of security not subject to state level review, but which will not receive adequate attention at the federal level. Regulation A securities are sometimes high-risk offerings that may be susceptible to fraud, making the protections provided by state review essential. To address these concerns, the Democrats offered an amendment to clarify that state securities regulators would face a far narrower preemption. Specifically, the amendment clarified that state securities regulators would only be preempted if the Regulation A security is sold on an exchange or sold only to a qualified purchaser. While that amendment was defeated, we will continue to work to ensure that the final bill provides adequate oversight. *Id*. at 13.

Continued bipartisan consultations in Congress ultimately resulted in a legislative consensus that removed from the bill the preemption of state authority to review and qualify Regulation A Plus securities offered or sold by brokers or dealers. H.R. 1070, 112th Cong. (as passed, Nov. 2, 2011). This legislative consensus in favor of eliminating broad preemptions of state authority from the bill was central to the legislation's eventual passage by the House with broad bipartisan support.

The procedural significance of the legislative consensus to remove preemption from the bill and the intent of its sponsors and Congress in this regard were summarized by one of the bill's Floor Managers, Congressman Gary Peters, during debate of H.R. 1070 on the Floor of the House of Representatives:

> Finally, the gentleman from Arizona [Mr. Schweikert] has also worked with Democrats on the remaining issue of contention, and that was the preemption of State law. The gentleman from Arizona's substitute amendment to H.R. 1070 removes the exemption from State level review that was previously provided to an issuer using a broker-dealer to distribute and issue. Regulation A securities can be high-risk offerings that may also be susceptible to fraud, making protections provided by the State regulators an essential [feature]. 157 CONG. REC. H7231 (daily ed. Nov. 2, 2011) (statement of Rep. Peters).

Notwithstanding the expressed intent of Congress, the Commission finalized a rule to implement Title IV that refutes Congress's clear direction regarding the scope and intent of the "qualified purchaser" exemption. This rule imposes precisely the type of broad preemption of state authority that Congress decisively rejected. By adopting a rule that effectively defines any purchaser of a Regulation A Plus security as a "qualified purchaser," irrespective of such investor's circumstances, sophistication, or any other criteria, the Commission effectively preempted all state authority to review Regulation A Plus, Tier 2 offerings. Such broad preemption should only occur with the express consent of Congress, and it certainly should not occur against clear Congressional intent to the contrary.

The SEC's claim of authority to define a "qualified purchaser" as any purchaser of a Regulation A Plus, Tier 2 security is in direct conflict with well-established legislative history, past positions held by the Commission itself, and pure common sense. Congress has made clear that the "primary factor" in defining the extent of this state-law exemption "must be the financial sophistication of these investors." 66 Fed. Reg. at 66,845. Even the Commission has previously stated that it believes "the nature of the investor rather than the investment is the critical feature in the determination of whether transactions with qualified purchasers should be exempt from state registration." *Id*. Finally, by the very construction of the term 'qualified,' purchasers were meant by Congress to be a subset of securities purchasers – not all of them.

In its final rule, the SEC incorrectly argues that the only type of preemption that Congress considered but rejected was for offers and sales through a broker or dealer, ignoring that the limited types of preemption permitted by the statute include specific protections for retail investors. 80 Fed. Reg. at 21,860. Congress was comfortable preempting the authority of the states when securities are sold on an exchange because exchanges impose heightened standards on listed securities, such as corporate governance requirements or stock liquidity assurances. Congress was also comfortable that the sophistication of a qualified purchaser reduces the need for additional state oversight, in the same way that rules for private securities

sold under Rule 506 of Regulation D, 17 C.F.R. § 230.506, preempt state regulation. However, Congress understood that preempting state securities regulators when Regulation A Plus securities are offered or sold by a broker or dealer would amount to a "blanket exemption" for all issuances of such securities. Markup of H.R. 1070 (statement of Rep. Barney Frank, Ranking Member, H. Comm. on Fin. Servs). In limiting preemption to these two narrow instances, Congress concluded state oversight was still needed to protect retail investors, including when such securities are offered or sold by a broker or dealer.

Furthermore, by defining "qualified purchaser" as "any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A," 80 Fed. Reg. at 21,858, the SEC, through rulemaking, has rendered the investor protections of listing on a national exchange meaningless. Congress included this provision precisely because a listing on a national exchange comes with oversight and standards set by the exchange. Additionally, listing on a national exchange entails a fair amount of secondary market liquidity, which is also a protection for ordinary investors. Congress knows that securities sold over the counter or off exchange are highly risky to ordinary investors and provide opportunity for "pump and dump" schemes. *Legislative Proposals to Promote Job Creation, Capital Formation, and Market Certainty: Hearing Before the Subcomm. on Capital Mkts. and Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 112th Cong. (2011)

(statement of Damon A. Silvers, Policy Director and Special Counsel of AFL-CIO). In a 2006 study of SEC enforcement actions, researchers found that more than 80% of manipulation cases involved such non-exchange traded stocks. Rajesh Aggarwal & Guojon Wu, *Stock Market Manipulations*, 79 J. BUS. 1915, 1935 (2006). Thus, Congress included the exemption for securities listed on a national exchange precisely because of the protections provided for ordinary investors through the listing and offering process.

Congress also demonstrated with Title III of the JOBS Act, which contains explicit and broad preemption in contrast to Title IV, that it knows how to preempt state laws when it wishes to do so. Congress explicitly preempted state law in Title III because of the investor protections provided for offerings made through crowdfunding portals, including a public review period and withdrawal rights. 158 CONG. REC. S5477 (daily ed. July 26, 2012) (statement of Sen. Merkley). Title IV does not include such language and therefore cannot be read as granting the Commission broad authority to preempt state review of Regulation A offerings.

We are alarmed by the Commission's decision to promulgate a rule that is clearly at odds with Congressional intent. The Commission has no authority to substitute its own preference for the judgment of Congress regarding preemption of state law—to do so is both unlawful and likely unconstitutional. Given the States' historic role as the primary regulators of smaller offerings and express

congressional intent to preserve the States' authority over Regulation A Plus securities, we believe the Commission has significantly overstepped its authority in broadly defining "qualified purchaser" in the final rule.

CONCLUSION

For the foregoing reasons, the Court should grant Petitioner's request to vacate the rule and issue a permanent injunction prohibiting the Commission from implementing and enforcing the rule.

Dated: September 2, 2015

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPESTYLE REQUIREMENTS

1. This brief complies with the type-volume limitations of Fed. R. App. P. 29(d), because it contains 2,468 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6), because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2013 in 14-point Times New Roman font.

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CERTIFICATE OF SERVICE

I hereby certify that on September 2, 2015, I caused the foregoing "Brief of Current and Former Members of Congress as *Amici Curiae* in Support of Petitioner" to be electronically filed using the Court's CM/ECF system, which served a copy of the document on all counsel of record in the case.

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