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PUBLIC INTEREST COMMENT

DOES THE SEC HAVE LEGAL AUTHORITY TO EXCEED STATUTORY DOLLAR LIMITATIONS?

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Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets
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Thank you for the opportunity to comment on the proposals in Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets (Exemption Proposing Release). We are scholars with the Mercatus Center at George Mason University. Andrew Vollmer formerly taught securities regulation at the University of Virginia School of Law and served as deputy general counsel at the SEC. Brian Knight is the director of the Program on Innovation and Governance at the Mercatus Center. The Mercatus Center is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the effects of regulation on society. Our interest in providing this comment is to address the SEC's use of the exemptive and rulemaking process for certain parts of the proposal. The comment is not submitted on behalf of any other person or group.

The changes described in the Exemption Proposing Release would increase access to capital, increase opportunities for investors, and simplify and harmonize aspects of several of the exemptions from the registration requirement in section 5 of the Securities Act. As a general rule, we support those efforts as a matter of policy and commend the SEC for seeking ways to improve the securities markets for both large and small issuers and investors.

We write to address a different issue. That issue is the legal authority of the SEC to adopt some of the proposals.

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The Exemption Proposing Release says that the SEC plans to amend two regulations permitting security offerings exempt from the section 5 registration requirement, allowing issuers to raise larger amounts than Congress set in the statutes authorizing the exempt transactions. The proposals are to raise the issuer dollar limit in Rule 504 from $5 million to $10 million and in Regulation Crowdfunding (Reg CF) from $1.07 million to $5 million (Increased Dollar Limits).[1] The original statutory source for Rule 504 was section 3(b)(1) of the Securities Act, which has an issuer limit of $5 million. The original statutory source for Reg CF was sections 4(a)(6) and 4A. The issuer limit was $1 million and is now $1.07 million.

The SEC says it would use its general exemptive authority under section 28 of the Securities Act to raise the maximum offering amount for Rule 504 and Reg CF.[2] The SEC also cites its general rulemaking power in section 19(a) as a legal basis for the entirety of the Exemption Proposing Release.[3]

The Increased Dollar Limits raise questions about the SEC's legal authority under the Constitution and the Securities Act because they would exceed the maximum amounts Congress set for the small offering and crowdfunding exemptions in the statutes. The need for federal agencies to stay well within the powers granted to them by Congress is fundamental to the structure of American government and is a principle even more important than expanding access to capital and reducing regulatory burdens.[4]

In this comment, we describe our concerns and ultimately urge that the SEC not adopt a final rule that disregards a statutory dollar limitation without carefully considering its legal authority to take that action and without appropriately explaining that authority in the adopting release. We rely on the text, history, structure, and context of the Securities Act.[5]

Some of the proposals in the Exemption Proposing Release other than the Increased Dollar Limits raise similar authority questions, but this comment addresses only the proposals to change the dollar limits on issuer offerings. To the extent that the concerns in this comment apply to other proposals, we ask that the SEC consider the question of its delegated power and explain why it may adopt the proposed change.

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1. The SEC also proposed to increase the dollar limit in Regulation A, Tier 2 from $50 million to $75 million. The source of the $50 million limitation was section 3(b)(2) of the Securities Act, but section 3(b)(5) required the SEC to review the $50 million figure in section 3(b)(2) every two years and gave the SEC power to "increase such amount as the Commission determines appropriate."
2. Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 85 Fed. Reg. 17956, 17992, 17994 (proposed Mar. 31, 2020) (to be codified at 17 C.F.R. pt. 227, 229, 230, 239, 249, 270, 274).
3. *Id.* at 18038.
4. *See* Utility Air Regulatory Group v. EPA, 134 S. Ct. 2427, 2446 (2014) (allowing an agency to rewrite statutory thresholds "would deal a severe blow to the Constitution's separation of powers"); City of Arlington v. FCC, 133 S. Ct. 1863, 1868 (2013) ("No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, *whether the agency has stayed within the bounds of its statutory authority*.") (emphasis in original); Stark v. Wickard, 321 U.S. 288, 309 (1944) ("When Congress passes an Act empowering administrative agencies to carry on governmental activities, the power of those agencies is circumscribed by the authority granted."); California Independent Sys. Operator Corp. v. FERC, 372 F.3d 395, 398 (D.C. Cir. 2004) (a federal agency is a creature of statute, has no constitutional or common law existence or authority, and has only those authorities conferred on it by Congress).
5. The reports from committees of Congress at the time the SEC's general exemptive authority was added are not relevant to the questions discussed here. *See* H.R. Rep. No. 104-622 (1996); S. Rep. No. 104-293 (1996). Many members of Congress do not read committee reports. Ganesh Sitaraman, *The Origins of Legislation*, 91 Notre Dame L. Rev. 79, 90 (2015). Neither the full House nor the full Senate voted to approve the language in the reports, and the reports of specific committees did not necessarily state the understanding, meaning, or goals of a majority of the members of Congress at the time. *See* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 376 (2012); Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 783 (2018) (Thomas, J., concurring in part and concurring in the judgment).

GENERAL EXEMPTIVE AUTHORITY

Congress enacted the general exemptive authority in section 28 of the Securities Act in 1996. The section permits the SEC to exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any statute or rule in the Securities Act "to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."

The general exemptive authority is broad, but it is not unbounded. An exemption must be in the public interest and consistent with investor protection, and it has other natural boundaries. Two restrictions on the general exemptive authority appear to be relevant to the Increased Dollar Limits, although other restrictions also exist.

First, the exemptive power likely does not reach a specific dollar amount in a statute that reflects Congress's balance of relaxations and additional investor protections for a transaction exempt from the registration requirement. The statutes authorizing Rule 504 and Reg CF have those characteristics.

Both section 3(b)(1) and section 4(a)(6) have precise dollar ceilings for the amount of an issuer offering, and Congress demonstrated its desire to retain control of the numbers. Congress was emphatic that the SEC not use the exemptive power in section 3(b)(1) to exceed that dollar limit: "no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $5,000,000." The reference to an exemption under this subsection does not unequivocally prevent the use of the section 28 exemptive authority, but it is a strong indicator.

Another indicator is that the historical practice has been for Congress—not the SEC—to increase the statutory dollar amount in section 3(b)(1) from time to time. The amount started as $100,000 in the 1933 enactment of the Securities Act.[6] Congress raised it from $500,000 to $1.5 million in 1978 and from $2 million to $5 million in 1980.[7]

The $1 million issuer dollar limit for the crowdfunding exemption in section 4(a)(6)(A) (now $1.07 million) was set after congressional debate, negotiation, and compromise: the limit started at $5 million, changed to a two-tier limit of $1 million and $2 million, and ended at $1 million.[8] In section 4A(h)(1), Congress gave the SEC power to adjust the issuer dollar limit but only to reflect a change in the Consumer Price Index. Thus, Congress engaged in a legislative give-and-take to set the $1 million limit as part of the overall crowdfunding exemption and was explicit about the narrow circumstances in which the SEC could increase the crowdfunding number. Congress did not give the SEC a more general power to increase this limit, as it did with the $50 million limit in section 3(b)(2). Congress's close attention to the issuer dollar limitation for crowdfunding is peculiar if the SEC has the ability to change it through the exemptive authority.

The statutes authorizing Rule 504 and Reg CF also have additional investor protections. The predicate for a section 3(b)(1) exemption is "the small amount involved or the limited character of the public offering." The statutes on crowdfunding, sections 4(a)(6) and 4A, have investor dollar

6. Securities Act of 1933, Pub. L. No. 22, ch. 38, 48 Stat. 77 (1933).

7. Securities Investor Protection Act Amendments of 1978, Pub. L. No. 95-283, § 18, 92 Stat. 275 (1978).

8. Stuart R. Cohn, *The New Crowdfunding Registration Exemption: Good Idea, Bad Execution*, 64 Fla. L. Rev. 1433, 1437 (2012); *see also* Thomas Murphy, Note, *Playing to a New Crowd: How Congress Could Break the Startup Status Quo by Raising the Cap on the JOBS Act's Crowdfunding Exemption*, 56 B.C.L. Rev. 775, 796–97 (2017).

restrictions, require issuer disclosure and the use of an intermediary, and impose a variety of requirements on the issuer and the intermediary.

Sections 3(b)(1), 4(a)(6), and 4A are the result of a legislative process to determine, and to balance the exemption from registration with, the public interest and the protection of investors. Congress made judgments about the proper combination of features for the exemptions to meet its standards for the public interest and investor protection. The specific dollar limitations in sections 3(b) and 4(a)(6) appear to have been an essential part of the congressional plan for the exemptions from registration. In statutory text and historical practice, Congress has exercised control over the figures and has not left much room for agency action.

Regardless of whether the balance struck was wise, Congress used its constitutional authority to establish the terms. Even if the SEC's modifications are better policy, suboptimal securities laws would be better than improvement by agency lawmaking that is potentially unconstitutional. The SEC should not modify the issuer dollar limitations and change the public interest–investor protection balance established by Congress unless the agency provides a solid explanation to the public that use of the exemptive authority is permissible.

At a minimum, overriding a specific dollar limit on a registration exemption would likely be at the outer edges of the SEC's authority under section 28, and that is itself a public interest consideration. To maintain respect and legitimacy, federal agencies should be careful about entering into gray areas of their statutory powers. A use of legal authority that the public reasonably could see as treading into Congress's area of responsibility could cast doubt on the propriety and legality of other agency actions and, therefore, might not, on balance, be in the public interest. This is all the more reason for the SEC to provide a clear and compelling case for its actions or refrain from exceeding, or giving the appearance of exceeding, constitutional limitations.

A second restriction on the SEC's general exemptive authority that the text of section 28 seems to create is that an exemption must have a limited scope. It must be an exception or relief from a more generally applicable statutory or regulatory obligation. The original legal obligation, here the $1 million or $5 million limit, must continue to exist for some persons or transactions.

Section 28 provides that the SEC may "exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision" or regulation of the Securities Act. The text provides that an exemption is an exception or relief from a specific legal obligation. It must alleviate, lift, limit, or dispense with a legal requirement.[9] When it does so, this exemption must be for a subset of the entire group of persons or things encompassed by the original legal provision. It can be case-by-case or for a class, but it must be for a subset.[10] Courts do not favor blanket exemptions. The US Court of Appeals for District of Columbia Circuit reviewed an EPA attempt "to promulgate a blanket exemption from statutory requirements,"[11] noting that the "EPA's action reflects no choice to exercise administrative discretion based on circumstances

9. Cary Coglianese et al., *Unrules*, 73 Stan. L. Rev. (forthcoming) (Univ. Pa. Carey Law School, Public Law and Legal Theory Research Paper Series, No. 20-37, 2020) 1, 9, ssrn.com/abstract=3701841; Admin. Conf. of the U.S., Regulatory Waivers and Exemptions, Recommendation 2017-7, 82 Fed. Reg. 61742, 61742 (Dec. 29, 2017).

10. American Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 21 (D.D.C. 2013) (an exemption "by definition, is an exclusion or relief from an obligation, and hence will be inconsistent with the statutory requirement on which it operates"); Coglianese et al., *supra* note 9, at 8–9.

11. Alabama Power Co. v. Costle, 636 F.2d 323, 357–59 (D.C. Cir. 1979).

peculiar to the individual case."[12] The court offered this guidance: "Categorical exemptions from the clear commands of a regulatory statute, though sometimes permitted, are not favored."[13]

The proposals for the Increased Dollar Limits appear to be more like a blanket exemption. They would apply to every transaction under Rule 504 or Reg CF. They would create new exemptions not permitted by adherence to the statutory dollar limitations and would not relieve only one person or transaction or a class of persons or transactions from the maximum dollar amounts the statutes allow an issuer to raise. In practical effect, the proposed dollar increases would amend the statutes by creating the small-dollar and crowdfunding-exempt transactions for all persons, all securities, and all transactions otherwise complying with the terms of the exemptions from registration. If the SEC proceeds, it should explain how the general exemptive authority reaches that far.

QUESTION ABOUT PREEMPTION OF STATE SECURITIES REGULATION

The SEC might reject these concerns about the use of the general exemptive authority on the ground that the agency would be creating two new exemptions under section 28 that would be disconnected from any statutory limitations in sections 3(b)(1), 4(a)(6), and 4A. That was the position of the SEC when it created a special intrastate offering exemption in Rule 147A that did not include several of the requirements in the originating statute, section 3(a)(11).

Such an approach would have two difficulties. The first is that, for the reasons already given, the SEC should ask whether such an interpretation of section 28 would be appropriate or would be artificial and a misuse of the exemptive authority, given the unequivocal statutory plan. The features Congress demanded for the relevant exemptions from registration are unmistakable and include maximum issuer dollar amounts that the SEC proposes to avoid.

Second, adopting a new crowdfunding exemption in which issuers could raise up to $5 million—a Reg CF-A, as one might call it—by taking an approach similar to the one the SEC used for Rule 147A would be unmoored from section 4(a)(6). That approach would raise a significant doubt that securities issued under a Reg CF-A would be "covered securities" free of the registration and qualification obligations in state law.

Section 18 of the Securities Act preempts parts of state securities regulation for enumerated covered securities, such as those issued in a transaction pursuant to section 4(a)(6) (see section 18(b)(4)(C)). Securities issued under a Reg CF-A would not be sold under a section 4(a)(6) exemption and would not be covered securities preempting state securities regulation unless the SEC were to find a different, valid basis for preemption. State law preemption is an important consideration because compliance with state registration and qualification standards increases costs that could make many crowdfunding issues in the $1 million to $5 million range uneconomical. This question does not arise for the intrastate transactions because section 18 explicitly excludes securities in section 3(a)(11) transactions from the definition of covered securities (section 18(b)(4)(E)), possibly because transactions based on the intrastate exemption stay within one state and do not face the costs of qualifying in many states.

12. *Id.*
13. *Id.*

Similarly, if the SEC uses section 28 to create a Reg CF-A divorced from section 4(a)(6), the registration obligations in section 12(g) of the Securities Exchange Act would apply to securities acquired in a Reg CF-A transaction. The current exclusion from section 12(g) in section 12(g)(6) applies to securities acquired in a section 4(a)(6) transaction.

Perhaps the SEC has developed and can make available to the public a legal interpretation that would permit the use of section 28 to override specific dollar limitations fixed by Congress, but the SEC should be careful of aggressive legal theories and recognize that adopting the Increased Dollar Limits would create tension with the statutory plan. In a paraphrase of the words often used in SEC rules, section 28 should not be available for any agency action that, although in technical compliance with section 28, is part of a plan to evade the registration provisions of the Securities Act.

RULEMAKING AUTHORITY

The SEC also cites its rulemaking authority in section 19(a) of the Securities Act as a source of power. That section gives the SEC authority to make "rules and regulations as may be necessary to carry out the provisions" of the Securities Act. The question of the extent of the SEC's rulemaking power is similar to the question of the SEC's authority under section 28: Does the SEC have the power to adopt a rule in disregard of maximum dollar amounts established by Congress in the Securities Act for exemptions from the registration requirement? Is such a rule necessary to carry out the provisions of the Securities Act?

The courts have been taking an increasingly careful look at the rulemaking authority of federal agencies and the plain meaning of relevant statutes.[14] They have been doing so whether they apply *Chevron* rigorously, lightly, or not at all.[15] The question for a reviewing court "is always whether the agency has gone beyond what Congress has permitted it to do."[16]

The SEC should consider whether adoption of the Increased Dollar Limits as a rule based on section 19(a) rather than section 28 would be likely to pass judicial review. Several judicial decisions counsel agency restraint, and the sentiment behind these opinions applies equally well to interpretations of the general exemptive authority in section 28.

In *Utility Air Regulatory Group v. EPA*,[17] the Supreme Court considered an EPA regulation that set a new permitting threshold of 100,000 tons per year for a substance, although the statute,

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14. *See, e.g.*, Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 781–82 (2018) (holding that an SEC regulation defining the term "whistleblower" was not valid because the statutory definition was clear and conclusive: "Because Congress has directly spoken to the precise question at issue, we do not accord deference to the contrary view advanced by the SEC in [the regulation]. The statute's unambiguous whistleblower definition, in short, precludes the Commission from more expansively interpreting that term."); *but see* Lindeen v. SEC, 825 F.3d 646 (D.C. Cir. 2016).

15. A standard description of judicial review of an agency rule under Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), is the following:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, applying the ordinary tools of statutory construction, the court must determine whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. But if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

City of Arlington v. FCC, 133 S. Ct. 1863, 1868 (2013).

16. City of Arlington v. FCC, 133 S. Ct. 1863, 1869 (2013).

17. Utility Air Regulatory Group v. EPA, 134 S. Ct. 2427 (2014).

"in no uncertain terms," required permits for sources with the potential to emit more than 100 or 250 tons per year.[18] The Court strongly criticized the agency:

> We conclude that EPA's rewriting of the statutory thresholds was impermissible . . . . An agency has no power to "tailor" legislation to bureaucratic policy goals by rewriting unambiguous statutory terms. . . . It is hard to imagine a statutory term less ambiguous than the precise numerical thresholds at which the Act requires . . . permitting. When EPA replaced those numbers with others of its own choosing, it went well beyond the bounds of its statutory authority.[19]

The Court cited the need to respect the Constitution's separation of powers. Congress makes laws, and agencies help the president execute them. The power of an agency to administer a statutory system "does not include a power to revise clear statutory terms that turn out not to work in practice."[20] The Court concluded that EPA lacked authority to issue the regulation:

> We reaffirm the core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate. EPA therefore lacked authority to "tailor" the Act's unambiguous numerical thresholds to accommodate its greenhouse-gas-inclusive interpretation of the permitting triggers. Instead, the need to rewrite clear provisions of the statute should have alerted EPA that it had taken a wrong interpretive turn.[21]

In *Financial Planning Ass'n v. SEC*,[22] the US Court of Appeals for District of Columbia Circuit reviewed the SEC's effort to write a rule to address the investment adviser activity of broker-dealers. The Investment Advisers Act of 1940 (IAA) excludes certain broker-dealer activity, but the SEC used definitional and rulemaking power given in the act to expand the exclusion. The court applied *Chevron* and found that the SEC did not have statutory power to adopt the rule because Congress had "addressed the precise issue at hand."[23] The court reasoned that the plain meaning of the legislation should be conclusive and that "the terms of the IAA establish the precise conditions under which broker-dealers are exempt from the IAA. To read out of a statutory provision a clause setting forth a specific condition or trigger to the provision's applicability is an entirely unacceptable method of construing statutes."[24]

These cases sound a cautionary note for the SEC. They illustrate how courts might perceive the Increased Dollar Limits as inconsistent with restrictions Congress has imposed.

CONCLUSION

The concern about the Increased Dollar Limits is about preserving the appropriate line between the role of Congress and the role of an administrative agency. We urge the SEC to recognize and

18. *Id.* at 2444–45.
19. *Id.* at 2445 (quotation marks omitted).
20. *Id.* at 2446.
21. *Id.*
22. Fin. Planning Ass'n v. SEC, 482 F.3d 481 (D.C. Cir. 2007).
23. *Id.* at 487.
24. *Id.* at 488 (quotation marks and ellipsis omitted). See also Natural Resources Defense Council, Inc. v. Costle, 568 F.2d 1369, 1377 (D.C. Cir. 1977) ("The wording of the statute, legislative history, and precedents are clear: the EPA Administrator does not have authority to exempt categories of point sources from the permit requirements of § 402. Courts may not manufacture for an agency a revisory power inconsistent with the clear intent of the relevant statute").

respect the boundaries to the exemptive and rulemaking powers and to consider whether adopting the Increased Dollar Limits goes too far toward effecting an amendment of the relevant statutes rather than implementing a rule to carry out the Securities Act or to grant needed exemptive relief.

At a minimum, the SEC should balance the risks from exceeding restrictions Congress imposed on the SEC's authority with the gains the SEC might realistically achieve by adopting the Increased Dollar Limits. Are the benefits to the securities markets from those higher issuer dollar limits, which apparently would be decidedly modest,[25] sizable enough to justify taking a position on the agency's power that could be questioned by a reviewing court, Congress, or the public?

We want to emphasize that we do not oppose the concept of raising (or perhaps even abolishing) the dollar limits available under Reg CF and Rule 504 as a policy matter. Quite the contrary: as a general rule, we support making the securities laws more accessible to both small issuers and small-dollar investors. At the same time, we believe that any move by the SEC to do so must be firmly grounded in legitimate constitutional authority rather than expediency. If the agency has good reasons for concluding that its exemptive or rulemaking power is muscular enough to overcome a dollar ceiling fixed by Congress, it should explain its views to the public. This will help the public and elected officials assess the SEC's proposal and decide if any changes to the law are necessary.

If, on the contrary, the SEC cannot firmly root its proposal within the clear bounds of its authority, it should refrain from taking an action that risks the SEC exceeding its authority and usurping power properly held by Congress. Instead, the SEC should discuss with Congress reasons for raising the issuer dollar limitations in the existing laws governing Reg CF and Rule 504 and work with Congress to reform the law. We appreciate that the SEC's intentions are to benefit the securities markets and submit these comments only to request that the SEC choose the most appropriate procedural approach.

25. Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 85 Fed. Reg. 17956, 17990–91, 17992, 18021–23 (proposed Mar. 31, 2020) (to be codified at 17 C.F.R. pt. 227, 229, 230, 239, 249, 270, 274).