UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 15-1080

JOHN P. FLANNERY,
Petitioner,
v.
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

No. 15-1117

JAMES D. HOPKINS,
Petitioner,
v.
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

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BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

COUNTERSTATEMENT OF THE ISSUES

James D. Hopkins, a former vice president and product engineer for State Street Global Advisors ("SSgA"), and John P. ("Sean") Flannery, a former Chief Investment Officer ("CIO") for the Americas at SSgA, petition for review of an order of the Securities and Exchange Commission finding that they violated the federal securities laws. The issues presented are:

1. Whether substantial evidence supports the Commission's findings that (a) Hopkins violated Section 17(a)(1) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a)(1), Section 10(b) of the Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5, by presenting materially misleading information at a meeting with investors; and (b) Flannery violated Securities Act Section 17(a)(3), 15 U.S.C. § 77q(a)(3), by helping to draft, edit, and approve two misleading letters to investors.

2. Whether the Commission reasonably interpreted Section 17(a)(3)'s prohibition against fraudulent practices and courses of business to encompass misrepresentations used to mislead investors.

3. Whether the Commission's finding that Flannery violated Section 17(a)(3) contravenes principles of fair notice or the rule of lenity.

4. Whether the Commission acted within its discretion in imposing a one-year suspension, cease-and-desist order, and $6,500 penalty on Flannery.

COUNTERSTATEMENT OF THE CASE

A. Nature of the Case

The Commission found that Hopkins violated the antifraud provisions of the securities laws by misrepresenting material facts about State Street Bank and Trust Company's ("State Street's") Limited Duration Bond Fund ("LDBF"), an

unregistered fixed-income fund, during a meeting with investors and consultants in May 2007. ADD85-92.[1] The Commission found that Flannery engaged in a course of business that operated as a fraud on investors by helping to draft, edit, and approve two misleading letters about LDBF in August 2007. ADD97-107. For their misconduct, the Commission suspended Hopkins and Flannery for one year from association with any investment adviser or investment company, imposed cease-and-desist orders on them, and ordered that they pay civil penalties. ADD109-16.

B. Facts

1. LDBF

In 2006 and 2007, SSgA, State Street's investment management division, provided management and advisory services to State Street funds, including LDBF. ADD61; JA990, 2929. LDBF was offered and sold to institutional investors. ADD61; JA805, 1482, 4363-65. Those investors included other State Street Funds (the "Related Funds"), clients of SSgA's internal advisory groups, and investors who were unaffiliated with either the Related Funds or the internal advisory groups. ADD62; JA524, 805, 1012-19, 1240-42.

From its inception in 2002, LDBF was heavily invested in asset-backed securities ("ABS"), a significant component of which were residential mortgage-

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[1] "ADD" refers to Flannery's addendum.

backed securities ("RMBS"). ADD61; JA4361-62. Over time, the fund became increasingly concentrated in subprime RMBS. ADD61; JA1195-96, 1803-10.

2. Hopkins

Hopkins was LDBF's "product engineer"; he was responsible for explaining to client-facing personnel—and, often, investors—LDBF's investment strategy. ADD62; JA798, 804, 808, 864. Hopkins also was responsible for ensuring the accuracy of SSgA's standard PowerPoint slides that he and others used in investor presentations. ADD62-63; JA836, 843, 916.

a. Typical Portfolio Slide

In 2006 and 2007, SSgA's standard presentation included a slide describing LDBF's "Typical Portfolio Exposures and Characteristics" (the "Typical Portfolio Slide"). ADD62-63; JA836, 4413. The slide described the fund's "typical" breakdown by sector, stating in part that LDBF was only 55% invested in ABS, even when the fund's exposure to ABS far exceeded that level. *Compare, e.g.*, JA2425, 4413 (slide as presented) *with* JA1803-10, 2425 (actual investment level). Throughout that time period, when asked if he wanted to update the standard presentation slides, and when reviewing them for accuracy, Hopkins consistently declined to update the sector allocation information in the Typical Portfolio Slide. JA836-44, 847-48, 4413.

Nevertheless, when preparing for investor meetings, Hopkins noted by hand on his copy of the Typical Portfolio Slide LDBF's *actual* sector allocations, including its actual exposure to ABS. JA832-40; *e.g.*, JA1725, 1885, 2062.[2] But he did not distribute his notes to meeting attendees, and there is no evidence that Hopkins otherwise corrected the inaccurate information about LDBF's ABS exposure during his presentations. *See* JA832-48, 916-17.

b. Hopkins's presentation of the Typical Portfolio Slide to Yanni Partners and National Jewish Medical and Research Center on May 10, 2007

In late 2006, home prices declined, and delinquencies and defaults in the subprime mortgage sector followed; as a result, in February 2007, LDBF suffered a serious decline in performance, much of which was attributable to its exposure to the lower-rated tranches of subprime RMBS. ADD64; JA1103, 1468, 1513, 2064-77.

On May 10, 2007, Hopkins gave a presentation to National Jewish Medical and Research Center ("National Jewish") to address LDBF's first-quarter losses arising from its exposure to subprime RMBS. ADD65; JA833, 925, 1413-16. Meeting attendees included representatives from Yanni Partners, an investment

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[2] Before a July 2006 presentation, Hopkins noted on his copy of the Typical Portfolio Slide that 90% of LDBF's assets were in ABS (JA836, 1714-61); before a December 2006 presentation, Hopkins noted that 80% of LDBF was in ABS (JA837, 1869-1915); and before a February 2007 presentation, Hopkins noted that 90% of LDBF was in ABS (JA838, 2055-63).

consulting firm that advised several institutions—including National Jewish—that invested in SSgA's Enhanced Dow Jones-AIG Commodities Index Fund (the "Commodities Fund"), which itself invested in LDBF. ADD65; JA581. Before the meeting, National Jewish was provided with SSgA's presentation materials, including the Typical Portfolio Slide. JA4391-4432.

Although Hopkins did not recall what he said during the meeting, another meeting attendee, David Hammerstein, did. JA834-35, 857-59, 945-46, 1413-15. According to Hammerstein, the chief strategist for Yanni Partners (JA1407-08), Hopkins specifically addressed the Typical Portfolio Slide during the presentation to demonstrate that LDBF "was very high quality" and "very diversified by sector." JA1414-15. Hammerstein testified that, in total, SSgA's presentation lasted for about thirty minutes, that Hopkins did most of the talking and appeared to have finished his presentation, and that Hopkins did not appear rushed. JA1413-14. Hammerstein also testified that he understood from Hopkins's presentation that LDBF's portfolio was allocated according to the percentages listed in the slide (*i.e.*, 55% in ABS). JA1414-15, 4413. Hammerstein stated that he found the information about LDBF's portfolio allocation important because "[i]t led to the impression that the fund was well diversified, and therefore that State Street took steps to reduce the risks or control the risks." JA1415. Contrary to the information

in the slide, however, at that time LDBF's exposure to ABS was at least 75%. *See* JA847-48, 4544.

c. Yanni Partners's discovery of LDBF's actual ABS exposure

By July 2007, credit downgrades of investments backed by subprime mortgages had created a market-wide liquidity crisis. ADD66; JA4858-61, 4897. As a result, LDBF experienced another round of significant losses; in late July, SSgA held a conference call with Yanni Partners to address the issue. JA1415, 2312-14, 4823-26. Hammerstein testified that it was only during that call that he learned that LDBF's actual exposure to ABS exceeded that described in the Typical Portfolio Slide—that it had been 100% as of March 31, 2007, and was 82% as of June 30, 2007. JA1416; *see also* JA2312-14, 2424-25.

Hammerstein's testimony—that, as of late July 2007, Yanni Partners realized that it had been "led to believe" inaccurate information about LDBF (JA1417)—is corroborated by a contemporaneously drafted Yanni Partners memorandum stating that LDBF "was much less diversified than" the May 10 presentation had indicated. JA2313-14 (noting also that the July call "was the first time" Yanni Partners had "learned that the entire [fund] was exposed to the sub-prime market as recently as 3/31/07"); *see also* JA4924 (minutes from August 2, 2007 Yanni Partners Investment Policy Meeting noting that SSgA had not "fully

disclos[ed]" information about its portfolio and that SSgA presentation materials "suggest[ed] a much more diversified strategy than was actually being employed").

On August 3, 2007, Yanni Partners recommended that its clients liquidate their holdings in SSgA's Commodities Fund (which was invested in LDBF). JA1417, 2386, 4924. Hammerstein testified that Yanni Partners made this recommendation because it believed that SSgA had not "adequately inform[ed] us of the risks in the portfolio, and we cited the example of the [May 10] presentation . . . [where] State Street stated that . . . the typical allocation was 55 percent to the ABS sector, but as recently as March 31 of 2007, the actual ABS allocation was 100 percent." JA1417. Hammerstein also stated that his clients suffered a loss of nearly 40% by investing in LDBF through the Commodities Fund. JA1419.

3. Flannery

Flannery was the CIO for the Americas at SSgA. ADD67; JA803, 991, 2223. He reported directly to SSgA's President and CEO, and SSgA's portfolio managers (including the manager responsible for LDBF) reported indirectly to him. ADD67; JA803, 990-92, 2223.

a. The July 25, 2007 SSgA Investment Committee meeting and subsequent liquidation of LDBF's highest-rated securities

As the subprime crisis deepened in the Summer of 2007, SSgA anticipated that many investors would seek redemptions from LDBF. ADD67; JA1040, 1046.

This was the subject of the July 25, 2007 meeting of the SSgA Investment Committee. JA1046-49, 1114-16, 2317-21. Flannery, who chaired the meeting, explained to attendees that the "overriding issue" they faced was how "to provide liquidity" by the end of July "if our clients want to leave the fund." JA1046, 2317-21. He observed that liquidity could be acquired in one of two ways: (1) sell just LDBF's most liquid assets, its AAA-rated bonds, which, if the anticipated redemptions occurred, would leave the fund "stuck with a lower quality portfolio" after the sale; or (2) sell a "pro-rata share" of assets across the portfolio, which, after redemptions, would "leave[] the remaining portfolio more like a pro-rata share." JA2320. Out of concern that LDBF could "end up with a less liquid" and lower value portfolio, Flannery advised that the committee should adopt the second (pro rata) approach. JA2318-21.

Others also acknowledged that the first approach—selling just the most highly rated securities—would, after redemptions, leave clients remaining in LDBF "with riskier lower grade" investments. JA2318. Indeed, one attendee even asked whether authorizing any sales at all would expose committee members "to fiduciary risk." JA2319. Another responded, "if no money moves (comes in or out)"—*i.e.*, if no redemptions occur—"then no; but if a client withdraws we will need to revalue the portfolio." JA2319. Mark Duggan, SSgA's Deputy General Counsel, also observed that the "wors[t] case scenario" would be if SSgA's

Related Funds redeemed from LDBF and remaining "clients in the fund . . . suffer[ed]." JA2320.

Ultimately, the committee instructed the portfolio management team to build 30 to 40% liquidity in LDBF by the end of July. JA2321, 1213-16, 1234-35. Accordingly, on July 26 and 27, the portfolio management team sold many of LDBF's highest-rated, and most liquid, assets—approximately $1.6 billion in AAA-rated bonds and $200 million in AA-rated bonds. JA972, 2761-64, 4322-24.

b. Investor redemptions

As the Investment Committee anticipated, many of LDBF's investors redeemed their investments in LDBF. JA3841-42, 2761-64. State Street's Related Funds redeemed essentially all of their investments, and several of SSgA's internal advisory groups recommended that their clients redeem, as well. *See* JA1014-17, 1243-48, 1392-93, 4066-80. On July 27, the head of one of those groups informed Flannery that she would advise her clients to liquidate by August 1. JA1014-16, 1247-48, 2636-40. By August 1, Flannery learned that another group had also recommended that its clients redeem. JA1017-18, 2349-63, 4066-80. Those redemptions, as well as redemptions by the Related Funds, began on July 27. JA2761-64, 3842-45. Many of the other, independent, LDBF investors did not receive advice recommending that they redeem, however, and thus they remained in the fund. *See* JA4944, 3842, 3846.

By August 2, all but between $175 million and $195 million of the proceeds from the July 26-27 sales had been used, in part to cover the investor redemptions. *See* JA972-73, 4322-24; FlanneryBr.18.[3] As a result, from July 26 to August 2, LDBF's portfolio composition changed substantially—from approximately 48% invested in AAA-rated securities to less than 5%, and from approximately 46% invested in AA-rated securities to over 80%. JA1214, 2764.

c. August 2 and August 14, 2007 letters to investors

In late July, SSgA executives began drafting a letter to investors about the effects of the subprime mortgage crisis on "SSgA's active fixed income and active derivative-based strategies," including LDBF (the "August 2 letter"). JA2346-48, 2375-80. After receiving an early draft, Flannery edited the last paragraph of the letter, which addressed the "risk profile[s]" of SSgA's funds. JA2364-67. In its final form, that paragraph stated, in relevant part:

> [T]he downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to seek to reduce risk across the affected portfolios. To date, in the Limited Duration Bond Strategy, we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. . . . The actions we have taken to date in the Limited Duration Bond Strategy simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies.

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[3] Approximately $1.1 billion of the proceeds was used to repay reverse repurchase commitments on the sold securities. JA972-73, 4322-24. LDBF had purchased the bonds using reverse repurchase agreements and had to unwind those agreements as part of its sale of the bonds. JA4339-40.

JA2375-80. Flannery reviewed a near-final version of the letter on or around August 2, 2007. JA1062, 1473, 2429-32.

Shortly thereafter, in early August, Flannery drafted and signed another letter to investors addressing the market decline and LDBF's continued poor performance (the "August 14 letter"). As Flannery testified, given "the seriousness of the problems with LDBF and the related funds," he believed that investors should hear from him directly. JA1066, 1139. His initial draft stated, in part:

> While we believe that the subprime markets clearly convey far greater risk than they have historically we feel that forced selling in this chaotic and illiquid market is unwise. . . . [W]e believe that liquidity will slowly re-enter the market and the segment will regain its footing. While we will continue to liquidate assets for our clients when they demand it, our advice is to hold the positions for now.

JA2434.

Both in-house and outside counsel reviewed Flannery's draft. JA1070-71, 1139-40, 2436-40. In its final form, the letter incorporated an edit from Duggan, who suggested that the final sentence quoted above be changed to read: "While we will continue to liquidate assets for our clients when they demand it, we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." JA2440, 2474-81. Flannery testified that he accepted the proposed edit because he believed the revised language remained "accurate"; in his view, it "didn't materially change" the recommendation that investors remain in LDBF. JA1143-44, 1070-71. The letter did not disclose to its

recipients that SSgA's internal advisory group clients and the Related Funds were redeeming (and had largely already redeemed) their shares. JA1250.

C. Proceedings Below

Following an evidentiary hearing, at which Hopkins, Flannery, and Hammerstein (among others) testified, an ALJ found that Hopkins and Flannery did not violate the antifraud provisions of the securities laws. ADD1-58.

On its *de novo* review of the record, the Commission determined that Hopkins violated Section 17(a)(1), Section 10(b), and Rule 10b-5 by presenting the Typical Portfolio Slide at his meeting with National Jewish on May 10, 2007. ADD85-92. The Commission found Hopkins not liable with respect to all of the other allegations. ADD85, 92-97. As to Flannery, the Commission found that the August 2 and August 14, 2007 letters misled LDBF investors and that by helping to draft, edit, and approve the letters, Flannery engaged in a course of business that operated as a fraud on investors in violation of Section 17(a)(3). ADD98-107. The Commission found Flannery not liable with respect to the other allegations. ADD98-107.

The Commission suspended both Hopkins and Flannery for one year from association with any investment adviser or investment company, imposed cease-and-desist orders on them, and assessed a civil penalty of $65,000 on Hopkins and $6,500 on Flannery. ADD109-16.

SUMMARY OF ARGUMENT

Substantial evidence supports the Commission's findings that Hopkins and Flannery violated the securities laws. Hopkins made a materially misleading misrepresentation when presenting the Typical Portfolio Slide at his meeting with National Jewish on May 10, 2007. The slide misrepresented LDBF's portfolio composition because, by 2006, the fund's exposure to ABS far exceeded the 55% investment level depicted in the slide, and reasonable investors would have wanted to know that LDBF's exposure to ABS was substantially higher than the slide represented. Hopkins acted with scienter because he knew at the time that the slide provided inaccurate information about LDBF, and he recklessly disregarded the risk that presenting the slide would mislead investors about LDBF's portfolio allocation. Accordingly, the Commission correctly found that, by presenting the slide, Hopkins violated Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5(a), (b), and (c).

Flannery engaged in a course of business that operated as a fraud on LDBF investors by negligently helping to draft, edit, and approve two letters to investors that contained materially misleading statements. The August 2 letter misled investors because it stated that the sale of LDBF's AAA-rated bonds reduced LDBF's risk, when in fact the sale, coupled with the anticipated immediate investor redemptions, increased the fund's risk. The August 14 letter misleadingly

stated that "judicious investors" would remain in LDBF, even though SSgA-affiliated investors were actually redeeming their shares and had done so by the time the letter was distributed. As the Commission found, reasonable investors would have wanted to know the truth about LDBF's risk and that SSgA's own funds and advisory groups were exiting (or advising their clients to exit) the fund. Flannery acted negligently because he unreasonably failed to correct the letters despite knowing facts that made them misleading. Because Flannery's repeated conduct occurred over a two-week period and encompassed more than one materially misleading communication, the Commission correctly found that he engaged in a course of business that operated as a fraud on LDBF investors in violation of Section 17(a)(3).

The Commission's interpretation of Section 17(a)(3)—specifically its reading of the provision to encompass misstatements and misstatement-related conduct—is correct because it follows directly from the statutory text, and, in any event, it deserves deference because it is reasonable. The Commission's application of its interpretation to Flannery also does not contravene either principles of fair notice or the rule of lenity. And the sanctions the Commission imposed on Flannery for violating Section 17(a)(3) were within the Commission's discretion.

ARGUMENT

I. Substantial evidence supports the Commission's determinations that Hopkins and Flannery are liable for violating the securities laws.

Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5, all prohibit fraud in securities transactions. Section 17(a)(1) and Rule 10b-5(a) both prohibit the use of "any device, scheme, or artifice to defraud." 15 U.S.C. § 77q(a)(1); 17 C.F.R. § 240.10b-5(a). Rule 10b-5(b) prohibits "mak[ing] any untrue statement of a material fact." 17 C.F.R. § 240.10b-5(b). Rule 10b-5(c) prohibits "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit." 17 C.F.R. § 240.10b-5(c). And Section 17(a)(3) contains language similar to Rule 10b-5(c), substituting "transaction" for "act." 15 U.S.C. § 77q(a)(3). Proof of scienter is required to establish violations of Rule 10b-5 and Section 17(a)(1); a showing of negligence is sufficient to establish liability under Section 17(a)(3). *See Aaron v. SEC*, 446 U.S. 680, 697 (1980); *SEC v. Ficken*, 546 F.3d 45, 47 (1st Cir. 2008).

On a petition for review, the Commission's "factual findings control if supported by substantial evidence." *Cody v. SEC*, 693 F.3d 251, 257 (1st Cir. 2012); *see also* 5 U.S.C. § 706(2)(A) (the Commission's legal conclusions must not be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"). Here, substantial evidence supports the Commission's determination that Hopkins violated Section 17(a)(1) and Rule 10b-5(a), (b), and (c) when, with

scienter, he materially misrepresented LDBF's portfolio holdings by presenting the Typical Portfolio Slide at the May 10, 2007 meeting with National Jewish. Substantial evidence also supports the Commission's determination that Flannery violated Section 17(a)(3) by negligently helping to draft, edit, and approve two misleading letters sent to LDBF investors in August 2007.

A. Substantial evidence supports the Commission's determination that Hopkins is liable for presenting the Typical Portfolio Slide at the May 10, 2007 meeting with National Jewish.

When Hopkins misrepresented LDBF's exposure to ABS at his meeting with National Jewish, he made a material misrepresentation in violation of Rule 10b-5(b), employed a device or artifice to defraud in violation of Section 17(a)(1) and Rule 10b-5(a), and engaged in an act that operated as a fraud on investors in violation of Rule 10b-5(c).

1. The Typical Portfolio Slide was false and misleading.

A statement is misleading if it would convey to a reasonable investor "a false impression." *SEC v. Texas Gulf Sulpher Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (en banc). Here, substantial evidence supports the Commission's finding that the Typical Portfolio Slide misrepresented LDBF's "typical" exposure to ABS and thus was misleading to LDBF investors. The slide stated that LDBF's "typical" ABS exposure was 55% (JA4413), but by 2006 LDBF's investment in

ABS far exceeded that level (JA1803-10, 2424-25 (68.5% in September 2006; 85.7% in December 2006; 100% in March 2007; and 81.3% in June 2007)).

Hopkins suggests that the Typical Portfolio Slide was *not* false or misleading because it showed only LDBF's "typical"—rather than "actual"—sector allocation. HopkinsBr.32. But the Commission correctly rejected this argument. ADD85. In no way did the slide depict LDBF's "typical" exposure to ABS in 2006 and 2007. Indeed, Hopkins himself admitted during the hearing that even if at one time LDBF's "typical" investment in ABS was 55%, by 2006 that figure was no longer "typical." JA843-44. Also, the record shows that Hammerstein, who attended the May 10, 2007 meeting, *was* misled about LDBF's portfolio by the Typical Portfolio Slide. JA1414-15. Hammerstein testified that, based on Hopkins's presentation of the slide, he understood that LDBF was "allocate[ed] among sectors based on these percentages," including "55 percent ABS." JA1414-15.

Hopkins also argues that, notwithstanding its inaccuracy, the slide was not misleading because SSgA disseminated "accurate data about LDBF's actual composition 'by sector' across this time period." HopkinsBr.32-33. But the slide's statement about LDBF's "typical" investment was *itself* false and misleading, regardless of any other information SSgA may have disseminated. As the Supreme Court has stated, publishing true facts alongside false ones may render a misstatement *immaterial* but it will not "lose its *deceptive* edge simply by

joinder with others that are true." *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097-98 (1991) (emphasis added). And, as discussed below, SSgA did not disseminate accurate information about LDBF in a manner sufficient to render the misstatement in the Typical Portfolio Slide immaterial.

2. The misrepresentation in the slide was material.

A misstatement is material if there is a "substantial likelihood" that "a reasonable investor would have viewed the [statement] as significantly altering the total mix of information made available." *Smith & Wesson Holding Corp. Sec. Litig.*, 669 F.3d 68, 74 (1st Cir. 2012). Materiality does not require proof that accurate disclosure would have caused an investor to change his or her decision, but only that such truthful information "would have assumed actual significance in [his] deliberations." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

Here, the Commission appropriately concluded that, at the time the misstatement was made, in 2006 and 2007, reasonable investors would have deemed it significant to the total mix of information available to them to know that LDBF's exposure to ABS was substantially higher than was stated in the slide. ADD86; *accord SEC v. Mudd*, 885 F. Supp. 2d 654, 666-67 (S.D.N.Y. 2012) (allegations of misrepresentations about subprime exposure in February 2007 satisfied materiality pleading requirements); *In re MBIA, Inc., Sec. Litig.*, 700 F. Supp. 2d 566, 579-81 (S.D.N.Y. 2010); *In re MoneyGram Int'l, Inc. Sec. Litig.*,

626 F. Supp. 2d 947, 975-78 (D. Minn. 2009). Indeed, as Hammerstein testified, he found the sector allocation information in the slide important because "[i]t led to the impression that the fund was well diversified." JA1414-15. And Hopkins himself testified that *SSgA* generally regarded information about its portfolio allocation as sufficiently important that it sought to avoid disclosing it in order to protect its competitive advantage. JA826.

None of Hopkins's three arguments for overturning the Commission's materiality finding has merit.

1. Hopkins erroneously contends that the slide's misstatement was immaterial because accurate information about LDBF's portfolio composition was presented in other places, including in SSgA's "Fact Sheets" about LDBF, which, he claims, were generally available to investors and consultants. HopkinsBr.43. The Commission appropriately rejected this argument. ADD87. Where misrepresentations are made directly to investors, it is no defense to a finding of materiality to claim that accurate or corrective information was available upon request or through the investors' own research efforts. *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1252-53 (11th Cir. 2012) (rejecting argument that misrepresentations were immaterial because accurate information was "available to any 'reasonably diligent investor'"); *N.J. Carpenters Health Fund v. Royal Bank of*

Scotland, 709 F.3d 109, 127 (2d Cir. 2013); *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 641 (D.C. Cir. 2008).

That rule holds especially true where, as here, any corrective information is not widely distributed to investors. *Morgan Keegan*, 678 F.3d at 1253. Indeed, Hopkins identifies no more than three instances in which the Fact Sheets were actually sent to investors or consultants. HopkinsBr.5, 32; *see also* JA812, 1587 (January 2006); JA814-15, 1916 (January 2007); JA864 (June 2007). Moreover, during the hearing, Hopkins's own attorney asserted that "[t]here has not been any testimony in this case" showing that the Fact Sheets were "typically distributed" to SSgA clients. JA1552. And Hopkins himself testified that SSgA did *not* generally provide clients with information about portfolio holdings because it would "give competitors an idea of how we're doing what we're doing." JA826. Thus, the record contradicts Hopkins's assertion that the Fact Sheets adequately "disclosed, on a regular basis, the actual composition of LDBF's portfolio." HopkinsBr.43.[4]

2. There is likewise no merit to Hopkins's argument that the Commission erred by using hindsight to find his misstatement material. HopkinsBr.41-42, 48. In fact, the Commission explicitly *rejected* the notion that

[4] Hopkins also cites no evidence that Yanni Partners or National Jewish ever received corrective information. And although Hopkins's attorney questioned Hammerstein at length about the May 10, 2007 meeting, he never asked Hammerstein whether Yanni Partners or National Jewish received such information. *See* JA1458-63.

the misstatement in the Typical Portfolio Slide became material "only *after* the financial crisis hit in July 2007." ADD86. Instead, it found that misrepresenting LDBF's exposure to ABS was material to investors at the time the misstatement was made. ADD86. Courts have made similar determinations. *E.g., Mudd*, 885 F. Supp. 2d at 666-67; *see also In re Bear Stearns Sec., Derivative, & ERISA Litig.*, 763 F. Supp. 2d 423, 487 (S.D.N.Y. 2011) (collecting cases holding that "[t]he incantation of fraud-by-hindsight will not defeat an allegation of misrepresentations and omissions that were misleading and false at the time they were made").

3. Finally, Hopkins misconstrues the Commission's analysis when he argues that the Commission held that only misrepresentations about portfolio composition that affect a fund's risk profile are material (and, he asserts, LDBF's higher exposure to ABS did not do that). HopkinsBr.44-45. The Commission did not premise its finding of materiality on LDBF's risk profile. Rather, the Commission appropriately concluded that the slide's misrepresentation was material because reasonable investors would have deemed it important to the total mix of information to know that LDBF's "typical" investment in ABS far exceeded the 55% level the slide depicted. ADD86-87.

To be sure, the Commission cited a case in which it made a "similar[]" finding that a change in a fund's composition was material because there the fund's

risk profile increased. ADD86 (citing *Fundamental Portfolio Advisors, Inc.*, 56 S.E.C. 651, 2003 WL 21658248 (July 15, 2003), *aff'd sub nom. Brofman v. SEC*, 167 F. App'x 836 (2d Cir. 2006)). But the Commission never suggested that only such changes are material. Rather, it reasonably determined that investors *also* would have wanted to know that LDBF's exposure to ABS was substantially higher than the slide stated. ADD86.

3. Hopkins acted with scienter.

Substantial evidence supports the Commission's finding that Hopkins acted with scienter when he made the misstatement in the Typical Portfolio Slide. This Court has held that "proving scienter requires a showing of either conscious intent to defraud or a high degree of recklessness." *Ficken*, 546 F.3d at 47 (internal quotation marks omitted). Recklessness is "an extreme departure from the standards of ordinary care . . . [that] presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious the actor must have been aware of it." *Id.* (internal quotation marks omitted). Hopkins mistakenly asserts that, to establish scienter, the Division *also* was required to show "a motive to mislead." HopkinsBr.51-52. That is incorrect. "The plaintiff in a securities fraud suit must show intentional deceit; the motive for that deceit is beside the point." *SEC v. Koenig*, 557 F.3d 736, 740 (7th Cir. 2009).

As the Commission found here, Hopkins's admissions during testimony and his contemporaneous notes establish that he must have known the slide was inaccurate as it was provided to investors and consultants in 2006 and 2007. *See* ADD90-91. Hopkins testified that, by 2006, the sector allocations described in the slide were no longer "typical" of LDBF's actual allocations. JA843-44. He also testified that, as of May 2007, the slide "was not accurate as an actual description of the [LDBF] portfolio," as the fund was "primarily" invested in ABS. JA847. Hopkins's handwritten notes on his copies of the slide further demonstrate that, by May 2007, he knew that LDBF's ABS exposure far exceeded 55%. *See supra* note 2. It was thus perfectly reasonable for the Commission to conclude that "this evidence shows that Hopkins must have known that the Typical Portfolio Slide would mislead LDBF investors, and he recklessly disregarded that fact." ADD90. Hopkins's three arguments for overturning that finding are unpersuasive.

1. Hopkins argues that he lacked scienter because the Commission's evidence "may show that [he] knew 'typical was not actual,' but this does not mean he knew the Slide would deceive investors." HopkinsBr.53. On the contrary, Hopkins's knowledge that "typical was not actual" is strong circumstantial evidence of his scienter. This Court has found "classic evidence of scienter" to be "the fact that the defendants published statements when they knew facts suggesting the statements were inaccurate or misleadingly incomplete."

Aldridge v. A.T. Cross Corp., 284 F.3d 72, 83 (1st Cir. 2002). Similarly, it has held that "[e]vidence . . . relevant to the scienter issue includes . . . disregard of current factual information acquired prior to the statement at issue." *Geffon v. Micrion Corp.*, 249 F.3d 29, 36 (1st Cir. 2001).

2. The evidence also belies Hopkins's claim that he lacked scienter because he did not know (or recklessly disregard) that investors would have found the misstatement about LDBF's sector allocations material. HopkinsBr.54-60. Hopkins plainly considered information about LDBF's actual portfolio composition sufficiently important that he made note of it before his presentations. *See supra* note 2. Hopkins also testified that he made these notes because he believed investors might ask him questions on the subject and he wanted to have "accurate information" available. JA845. In addition, Hopkins received—and responded to—requests from consultants, investors, and client-facing personnel for updated information about LDBF's ABS exposure before the May 2007 meeting. *See* JA825-26, 1852-59 (November 2006); JA855, 2771 (April 2007); *see also* JA2226-28 (June 2007); JA860, 924, 2233-37 (June 2007); JA867, 2290 (July 2007). As the Commission explained, these communications demonstrate that Hopkins "must have appreciated that the information was important to LDBF investors." ADD90. And all of this evidence shows that, as the Commission found, Hopkins knew—at the time, and not merely in "hindsight," as he claims—

that obtaining accurate sector allocation information was important to LDBF investors.

Hopkins erroneously asserts that the Commission's reliance on his handwritten notes means that every time he noted something and failed to say it at a presentation, he "thereby exposed himself to liability." HopkinsBr.57-58. The Commission did not base liability on Hopkins's failure to disclose his handwritten notes; it found him liable for providing false sector allocation information in the Typical Portfolio Slide. Hopkins's notes simply indicate that he knew both that information about sector allocations was important and that the information in the slide was not accurate.

Hopkins also faults the Commission for relying on his responses to inquiries about LDBF's portfolio composition, asserting that he responded to only one such inquiry before the meeting with National Jewish. But the record establishes that he responded to at least two such inquiries before May 10, 2007: On November 10, 2006, Hopkins emailed LDBF's portfolio allocation to an SSgA client-facing person expressing hope that the information "will satisfy your client" (JA825-26, 1852-59); and on April 25, 2007 (two weeks before the National Jewish meeting), Hopkins told LDBF's portfolio manager that he had recently responded to a question from a consulting firm about LDBF's portfolio allocation (JA855, 2771). In light of this evidence, it was reasonable for the Commission to conclude that

Hopkins must have appreciated the significance of the sector allocation information.

3. Finally, Hopkins misconstrues the relevant scienter inquiry by arguing that, in 2006 and 2007, he was unaware of any "danger" associated with LDBF's investments and thus necessarily lacked scienter. HopkinsBr.60-61. The relevant question, however, is not whether an individual foresaw market-wide "dangers" resulting in investment losses, but rather whether *his own conduct* presented an obvious "danger" of misleading investors. *Ficken*, 546 F.3d at 47-48. Here, as discussed, the record shows that: the Typical Portfolio Slide misrepresented LDBF's investment in ABS; Hopkins was aware of that misrepresentation; and, as Hopkins was aware, LDBF's sector allocation was important to LDBF investors. That is sufficient to establish—as the Commission found—that Hopkins's presentation of the misstatement in the Typical Portfolio Slide posed such an obvious danger of misleading LDBF investors that he, as an experienced securities professional, must have been aware of it. *See* ADD90-91.

4. Hopkins "made" the misrepresentation in the Typical Portfolio Slide during his May 10, 2007 presentation.

The Commission found Hopkins liable under Rule 10b-5(b) for the material misstatement in the Typical Portfolio Slide because he, with scienter, "made" the

misstatement.[5] "[T]he maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011). Substantial evidence supports the Commission's finding.

As the Commission explained, Hammerstein testified that Hopkins presented the slide during the May 10, 2007 meeting. ADD91; JA1414-15. Hammerstein testified that Hopkins used the slide to demonstrate that LDBF "was very high quality"; "[Hopkins] said it was very diversified by sector and he provided . . . a typical breakdown by sector." JA1414-15; *see* JA4413. Hammerstein testified further that he understood, based on Hopkins's presentation, that LDBF was "55 percent ABS" and that the slide gave "the impression that the fund was well diversified." JA1415; *see also* JA2386-88, 2413-15, 2424-25. Hammerstein testified that Hopkins did most of the talking during the 30-minute presentation, did not appear rushed, and finished his presentation. JA1413-14.

As the Commission noted, the ALJ "found Hammerstein to be a credible witness." ADD91 n.126; ADD47 n.78. The Commission "give[s] considerable weight to the credibility determination of a law judge since it is based on hearing

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[5] The Commission concluded that because Hopkins made a material misstatement with scienter in violation of Rule 10b-5(b), he also employed a device or artifice to defraud in violation of Section 17(a)(1) and Rule 10b-5(a) and engaged in an act that operated or would operate as a fraud or deceit in violation of Rule 10b-5(c). ADD92.

the witnesses' testimony and observing their demeanor." *Ralph Calabro, Jason Konner, & Dimitrios Koutsoubos*, Securities Act Release No. 9798, 2015 WL 3439152, at *10 (May 29, 2015); *see also Francis V. Lorenzo*, Securities Act Release No. 9762, 2015 WL 1927763, at *10 n.32 (Apr. 29, 2015) (the Commission does not accept credibility determinations "blindly"). Accordingly, the Commission appropriately credited Hammerstein's testimony that Hopkins had presented the Typical Portfolio Slide at the May 10 meeting. ADD91 n.126. But the Commission also found (ADD91) that additional record evidence supported Hammerstein's account: Hopkins was responsible for ensuring the accuracy of the information in the Typical Portfolio Slide (JA836, 843); Hopkins was consistently named as one of the lead presenters on the cover of presentations containing the slide (JA832, 916-17); and Hopkins regularly made handwritten notes on the slide in preparation for his presentations, indicating that he was generally responsible for delivering the portion of the presentation encompassing that material (JA832-33, 837-40, 916-17; *supra* note 2). From this evidence, the Commission reasonably concluded that Hopkins had ultimate authority over the misstatement in the Typical Portfolio Slide, at least with respect to the May 10, 2007 presentation. *See* ADD91-92.

Hopkins contends that the Commission erred in finding that he presented the Typical Portfolio Slide at the National Jewish meeting because, he claims, the

Commission improperly credited and relied on Hammerstein's testimony and then impermissibly shifted the burden of proof to Hopkins to present "compelling" evidence to overcome Hammerstein's account. HopkinsBr.20-31. His arguments lack merit.

1. Hopkins contends, first, that the ALJ was required to credit each of Hammerstein's statements *individually*—and that without such individualized credibility determinations, the ALJ's overall assessment that Hammerstein was credible (ADD47 n.78) is meaningless. HopkinsBr.23-25. He cites no authority for his position, however, and in fact courts have rejected that argument, explaining that "[a]n ALJ is not required to assess the credibility of every statement uttered by a [witness], because the ALJ's determination need not apply to particular, individual statements, but rather addresses the credibility of a [witness's] testimony overall." *Conn v. Colvin*, No. 14-cv-05698, 2015 WL 2089368, at *4 (W.D. Wash. May 5, 2015) (slip op.); *accord Shideler v. Astrue*, 688 F.3d 306, 312 (7th Cir. 2012).

Hopkins next suggests that even if Hammerstein's testimony can be believed, that testimony alone is insufficient to support the determination that he presented the Typical Portfolio Slide. HopkinsBr.25. But this Court has recognized that a witness's credible testimony that an event occurred is sufficient to support a finding that in fact such event took place. *United States v. Hahn*, 17

F.3d 502, 508 (1st Cir. 1994). And Hopkins errs in claiming that Hammerstein's testimony was somehow deficient because it was "uncorroborated." HopkinsBr.26. In fact, as discussed above, the record supports Hammerstein's account: It shows that Hopkins was generally responsible for the information in the Typical Portfolio Slide and gave the presentation about LDBF at the meeting with National Jewish.

Hopkins insists, however, that it *undermines* Hammerstein's testimony that much of the additional evidence about the National Jewish meeting is silent as to whether the Typical Portfolio Slide was presented or who presented it. *See* JA4435 (Hopkins's co-presenter's meeting notes); JA2091-92 (Hammerstein's meeting notes); JA4439-41 (National Jewish's Investment Committee minutes). But while there is no direct evidence that *corroborates* Hammerstein's account, there is certainly no evidence—direct or circumstantial—that *contradicts* it. Similarly, it does not diminish the veracity of Hammerstein's recollection of the meeting that his memory needed to be refreshed on other subjects. *See* HopkinsBr.27-28; JA1459 (Hammerstein, stating that he "clearly remember[ed]" the May 10 meeting).[6] Therefore, because Hopkins cannot identify evidence that

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[6] Hopkins also suggests that because the ALJ found that Hammerstein may have been confused as to certain statements Hopkins made in April 2007, it was improper for the Commission to rely on his account of the May 10 meeting. HopkinsBr.24-25. But the "genuine confusion" as to the financial data discussed

actually contradicts Hammerstein's account, and because he cannot show that the Commission erred in crediting Hammerstein's testimony, the Commission's finding should be upheld. *See United States v. Norman*, 776 F.3d 67, 79 (2d Cir. 2015) (direct testimonial evidence need not be corroborated by documentary evidence in order to be credited).

2. Hopkins incorrectly asserts that the Commission "got the law wrong" and misapplied "its own precedent" by requiring him to present "compelling," rather than "substantial," evidence to overcome Hammerstein's testimony. HopkinsBr.22. But when stating that it found "no compelling evidence" to contradict Hammerstein's account, the Commission was not purporting to articulate the legal standard required to overcome a credibility determination; rather, it was noting Hopkins's failure to present *any* evidence that he did *not* present the slide at the May 10 meeting. *See* ADD91, 92. This observation hardly constitutes the legal error that Hopkins suggests.

Moreover, the Commission and courts alike have described their approach to evaluating credibility assessments using precisely the language Hopkins challenges. *E.g.*, *Steven E. Muth & Richard J. Rouse*, 58 S.E.C. 770, 2005 WL 2428336, at *14 (Oct. 3, 2005) ("[W]e do not overturn credibility findings of the fact finder absent *compelling* evidence to the contrary." (emphasis added));

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in April 2007 (ADD48, 96) has no bearing on Hammerstein's testimony that Hopkins presented the slide at the May 10 meeting.

Swaters v. Osmus, 568 F.3d 1315, 1324 (11th Cir. 2009) (agency appropriately found that respondent had shown "no compelling reason . . . to overturn" ALJ credibility determination). And although the Commission has *also* characterized the evidence needed to overturn credibility findings as "substantial," an agency need not "invariably . . . parrot the same phrases or perpetually chant the same mantra." *Puerto Rico Aqueduct & Sewer Auth. v. EPA*, 35 F.3d 600, 609 (1st Cir. 1994).

B. Substantial evidence supports the Commission's determination that, by helping to draft, edit, and approve two misleading letters sent to investors, Flannery violated Section 17(a)(3) of the Securities Act.

Flannery engaged in a course of business that operated as a fraud on LDBF investors in violation of Section 17(a)(3) because, as a result of his negligent conduct, SSgA sent investors two letters that materially misled them about the nature of their investment in LDBF.

1. The August 2 and August 14 letters were misleading.

Substantial evidence supports the Commission's finding that the August 2 and August 14 letters "misleadingly downplayed LDBF's risk and encouraged investors to hold onto their shares, even though SSgA's own funds and internal advisory group clients were fleeing the fund." ADD98. As the Commission explained, the "backdrop" for these misleading communications was the July 25, 2007 Investment Committee meeting, at which attendees discussed how to provide

liquidity if investors wanted to leave LDBF. ADD68, 97-98; JA1114-16, 2317-21. At that meeting, Flannery acknowledged that, if SSgA sold LDBF's AAA-rated bonds "and the cash raised from the sale was 'siphoned' by redemptions (as they expected it to be) LDBF would be 'stuck with a lower quality portfolio' that was 'less liquid' and 'valued less.'" ADD68, 99; JA2318-21. Other attendees raised similar concerns. JA2318-21. Nonetheless, on July 26 and 27, SSgA sold from LDBF approximately $1.6 billion in AAA-rated bonds. JA972, 4322-24, 2761-64. And, by August 2, as Flannery was aware, SSgA's internal advisory groups had recommended that their clients redeem their positions in LDBF (JA1014-17, 1247-48, 2636-40, 2349-63), and the sale proceeds were being used to cover investor redemptions by the internal advisory group clients and the Related Funds (JA3842-45).

In light of these facts, the Commission reasonably found it misleading to state in the August 2 letter that the sale of the AAA-rated bonds had reduced LDBF's risk, and to state in the August 14 letter that SSgA believed judicious investors would continue to hold LDBF. The August 2 letter was misleading because, as the Commission explained, SSgA "never intended to hold cash or equivalent securities" after the sale of the AAA-rated bonds; instead, SSgA "sold the AAA-rated securities to fund expected redemptions in LDBF." ADD99-100. As a result, LDBF's sale of the AAA-rated securities "did not reduce risk in the

fund" because, as Flannery and others at the July 25 meeting anticipated, "the securities that remained in the fund had a lower credit rating and were less liquid than those that were sold." ADD99. The August 14 letter was misleading because, as the Commission stated, "it suggested that SSgA viewed holding onto the LDBF investment as a 'judicious' decision when, in fact, officials at SSgA had taken a contrary view, redeeming SSgA's own shares in LDBF and advising SSgA advisory group clients to redeem their interests, as well." ADD100.

Flannery's challenges to the Commission's determinations lack merit.

1. With respect to the August 2 letter, Flannery asserts that the letter was accurate because it described the steps SSgA had taken "to seek to reduce risk" and, he claims, there is "no evidence that the transactions were not intended to reduce risk." FlanneryBr.36-37. But Flannery ignores the last sentence of the letter, which stated, in part, that the "actions we have taken to date in [LDBF] simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies." JA2379-80. As the Commission found, the letter as a whole "explains that SSgA *sought* to reduce LDBF's risk profile" *and* it asserts that SSgA in fact "*reduced* that risk, in part, by selling 'a significant amount' of its 'AAA-rated cash positions.'" ADD99 (emphasis added); JA2379-80.

Flannery also asserts that, in any event, the sale of the AAA-rated bonds "did reduce risk" because, as his expert witness Ezra Zask testified, it reduced

LDBF's exposure to risky subprime securities and reduced leverage. FlanneryBr.37. But Zask did not account for the purpose of the sale. As the Commission found, his testimony "assumed that the net proceeds of the sale would be held in cash or cash-equivalent securities, which are less risky than" subprime securities. ADD99; JA4340-44, 1369, 1371-72. Zask ignored the fact that SSgA sold the AAA-rated bonds not so as to hold the cash, but to pay expected redemptions, which it did. *See* JA4340-44, 1369, 1371-72. The Commission thus reasonably concluded that Zask's testimony did not establish that the sale reduced risk. ADD100; *see also* JA1238-39 (LDBF's portfolio manager explaining that when cash is drawn down to cover redemptions, risk increases).

Flannery asserts further that the Commission was "wrong" to say that the redemptions from LDBF meant that the sale of the AAA-rated bonds increased LDBF's risk because, according to him, "approximately half the cash raised in the AAA sale remained in LDBF on August 2." FlanneryBr.37, 18. But Flannery himself admits that LDBF sold $1.54 billion of AAA bonds and there was only $175-$195 million left by August 2 after investor redemptions. FlanneryBr.16, 18; ADD68. Flannery claims that this amount was "nearly half" of the proceeds from the sale of the AAA bonds because LDBF retained only $420 million of the $1.54 billion after repaying repurchase commitments on the securities sold. FlanneryBr.18. But the fact that the cash from the sale of the AAA bonds was

largely exhausted both by repaying repurchase commitments and by investor redemptions is irrelevant; the point is that LDBF sold its highest-rated assets and did not retain the proceeds of the sale. The sale of the AAA bonds thus increased LDBF's risk because, as expected, investor redemptions began immediately afterwards (JA3842-45), and as Flannery and others foresaw at the July 25 Investment Committee Meeting, without the cash from the sale, LDBF was "stuck with a lower quality portfolio" that was "less liquid" and "valued less." JA2318-21.[7]

2. With respect to the August 14 letter, Flannery contends that the statement "we believe many judicious investors will hold the positions" is "not actionable" because it is an opinion he believed. FlanneryBr.40. In *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, the Supreme Court held that a statement of opinion may be misleading, and thus actionable, if it "omits material facts about the issuer's inquiry into or knowledge concerning" the opinion because an investor "expects not just that the [speaker] believes the opinion . . . but that it fairly aligns with the information in [his] possession at the time." 135 S. Ct. 1318, 1328-29 (2015). This Court too has recognized that an opinion "may still be

[7] The Commission did not "disregard[] the risk reduction resulting from the other two transactions identified in the letter" (FlanneryBr.38); it noted that even if these other transactions reduced risk, "the August 2 letter still would have been misleading because it represented that *each* of the stated actions reduced risk." ADD100 n.145.

misleading if it . . . knowingly omits undisclosed facts tending seriously to undermine the accuracy of the statement." *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 775 (1st Cir. 2011). Here, the August 14 letter failed to disclose, as Flannery knew, that judicious investors such as the Related Funds and internal advisory group clients were exiting the fund.

Flannery also erroneously argues that the statement was accurate because it "did not say that Flannery believed 'all' judicious investors would remain invested" but rather "that 'many' would." FlanneryBr.41. But as the Commission explained, "the reference to 'many,' not 'all,' investors hardly constitutes an accurate disclosure given that the letter omits *any* recognition that Flannery knew that many 'judicious investors' (SSgA itself, as well as clients advised by SSgA) actually planned to exit (and had already exited) the fund." ADD101.

Flannery argues further that the statement was accurate because many Related Funds "were taking redemptions in-kind, and thus remained invested in the LDBF strategy" and "exposed to the same assets they had been exposed to in LDBF." FlanneryBr.41-42. But, as the Commission found, that "some investors redeemed in-kind for the 'assets in LDBF's *strategy*' . . . does not establish that 'judicious investors' wanted to hold onto shares of *LDBF itself*." ADD101. Contrary to what Flannery asserts (Br.42), this distinction is meaningful because

investors in LDBF faced a daily risk that other shareholders would redeem and siphon liquidity from the fund. Indeed, Flannery himself recognized this problem when he created LDBF II, a fund that followed the same investment strategy as LDBF but permitted redemptions to occur only monthly. JA1120. The letter's suggestion that judicious investors would hold their positions in LDBF itself was therefore misleading; it did not state that such investors would want to hold onto assets in "LDBF's strategy."[8]

Finally, Flannery contends that the statement was not misleading because "the August 6 letter announcing LDBF II disclosed that the Related Funds were redeeming in-kind" and thus investors "were well aware of significant redemptions from LDBF before August 14." FlanneryBr.42. As discussed below, however, the disclosure in the August 6 letter was inadequate. The letter disclosed only that "[c]ertain SSgA" internal advisory groups "intend[ed] to redeem in-kind" their shares in LDBF—not that those groups and the Related Funds had *already* redeemed a large portion of their LDBF holdings for cash. *See* JA4139-42.

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[8] Flannery suggests that the letter's reference to "hold[ing] positions" conveyed that investors should remain in LDBF's assets, not LDBF itself. FlanneryBr.42. But no reasonable investor would interpret this statement to mean that they should in fact sell LDBF only to then buy LDBF's underlying assets.

2. The misrepresentations in the letters were material.

The Commission found that the misleading statements in the August 2 and August 14 letters were material because the total mix of information would have been altered had the letters disclosed the ultimate impact of the sale of the AAA-rated bonds on LDBF's risk profile, or that SSgA's own funds and SSgA-advised investors fled the fund in late July and early August. ADD102. Flannery challenges the Commission's finding on the ground that it discounted both the availability of information from other sources and the sophistication of LDBF's investors. FlanneryBr.52-53. But he fails to establish that the statements were immaterial.

1. Flannery argues that the Commission ignored that information about "liquidity issues" and redemptions was available to investors from other sources. But he does not explain how any other document alerted investors that—contrary to the representation in the August 2 letter—the sale of the AAA-rated bonds ultimately increased risk.

As for the August 14 letter, none of the documents Flannery highlights establishes that investors knew about the undisclosed redemption activity. The statement in the August 14 letter that SSgA would "continue to liquidate assets for [its] clients" who demanded it (FlanneryBr.53) did not, as the Commission found, constitute a disclosure about the nature or magnitude of the SSgA-driven

redemptions that had already occurred. ADD102. Similarly, the July 26 letter purportedly disclosing "liquidity issues and market turmoil" (FlanneryBr.52) says nothing about SSgA-driven redemptions. *See* JA4514-16. And the statement in the August 6 letter about anticipated in-kind redemptions (FlanneryBr.53) did not disclose that SSgA's internal advisory group clients or the Related Funds had already redeemed large positions for cash. *See* JA4139-42. Moreover, the in-kind redemptions did not begin until after large cash redemptions had taken place (*see* JA2715-18, 2746-52), and at least some of the in-kind redemptions took place on days that LDBF did not have sufficient cash to cover them. *Compare* Flannery Post-Hearing Reply Br. at 11, *John P. Flannery & James D. Hopkins*, File No. 3-14081 (May 6, 2011), *available at* https://www.sec.gov/litigation/apdocuments/3-14081-event-88.pdf (recognizing that LDBF had less than $300 million in cash on August 2 and 3) *with* JA2717 (two in-kind transactions on August 3 totaled approximately $300 million). A reasonable investor would have wanted to know that SSgA-driven redemption activity had already begun and that in-kind redemptions began only after redemptions for cash had occurred.

Finally, even if SSgA-driven redemption activity were included in FAQs used to respond to client inquiries (FlanneryBr.52), that is insufficient because, as discussed above, it is no defense to a finding of materiality to claim that accurate

or corrective information was available upon request or through the investors' own research efforts. *Morgan Keegan*, 678 F.3d at 1250-52.

In its *amicus curiae* brief, the Chamber of Commerce argues that in "transactions involving a limited number of investors directly interacting with their counterparties," the "ready availability of clarifying information" *is* a defense to a finding of materiality. ChamberBr.6-9. But the cases it cites for this proposition all involved misleading communications in the distinguishable context of negotiating a deal. *See Grigsby v. CMI Corp.*, 765 F.2d 1369, 1372-73 (9th Cir. 1985) (sale of minority shares of subsidiary to parent company); *Thomas v. Duralite Co.*, 524 F.2d 577, 584 (3d Cir. 1975) (sale of shares in a closely held corporation from one shareholder to another); *Pittsburgh Coke & Chem. Co. v. Bollo*, 560 F.2d 1089, 1091-92 (2d Cir. 1977) (sale of controlling stock in one company to another company); *Titan Grp. v. Faggen*, 513 F.2d 234, 239 (2d Cir. 1975) (acquisition by one company of four other companies); *Milton v. Van Dorn Co.*, 961 F.2d 965, 972 (1st Cir. 1992) (sale of stock of one of company's operating division to division's president).

There is no support for the Chamber's position that because investors in LDBF "received their communications either in letters or during in-person presentations" the hypothetical availability of corrective information had investors asked for it rendered the misleading statements in those communications

immaterial. No case holds that misleading communications about an investment in a fund are immaterial because investors received the communications in letters or in-person presentations and corrective information was theoretically available. Indeed, *Morgan Keegan* rejects this proposition. 678 F.3d at 1250-52.

As the Commission stated, it would send an "extraordinarily dangerous message" to hold that a speaker could make a misstatement about LDBF and have it be considered immaterial so long as he could claim that investors could have obtained accurate information about the fund had they known to ask. ADD87; *Stier v. Smith*, 473 F.2d 1205, 1208 (5th Cir. 1973) ("We should always be wary of holding that a purchaser of securities, who deals with a corporate insider, could have found out omitted material facts by examining the corporate books or undertaking other extensive investigations. [The insiders cannot] excuse themselves from liability on the basis that they did not provide the right answers because they were not asked the right questions.").

2. Flannery also erroneously argues that because *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), "held that materiality is fact-specific," and LDBF's investors were sophisticated, the Commission erred by not evaluating whether the misleading statements would be material to a reasonable sophisticated investor. FlanneryBr.53-54; *see also* ChamberBr.9. As the Commission recognized (ADD88), *Basic* itself found "no authority . . . for varying the standard of

materiality depending on" the recipient of "the withheld or misrepresented information." 485 U.S. at 240 & n.18. And, in any case, the Commission stated explicitly that, "even if we were to conduct the sort of materiality analysis Flannery insists is appropriate, we find that LDBF's investors still would have wanted to know the facts that SSgA failed to disclose because those investors (and the consultants they employed) were not necessarily uniformly knowledgeable about fixed income investing." ADD102.

The Chamber nonetheless insists that because LDBF's investors were "sophisticated" and "experienced," the "misleading information identified by the Commission was simply not significant enough to affect the large volume of information LDBF's clients already had available." ChamberBr.12-13. But it does so without discussing the facts the Commission found would have altered the total mix of information. The Chamber does not explain why disclosing that the sale of the AAA-rated bonds ultimately increased, rather than decreased, risk would not have been important to sophisticated or experienced investors. Nor does it explain why sophisticated or experienced investors would not have wanted to know that SSgA's internal advisory group clients and the Related Funds were exiting LDBF. These facts were not disclosed in the August 2 or August 14 letters or elsewhere and, as the Commission found, sophisticated or experienced investors would have

wanted to know them. *See Stier*, 473 F.2d at 1207 ("[S]ophisticated investors, like all others, are entitled to the truth[.]").[9]

3. Flannery acted negligently.

Substantial evidence supports the Commission's finding that Flannery "was negligent with respect to his contributions to and approval of the August 2 and 14 letters." ADD103. Negligence is the failure to exercise reasonable care, competence, or prudence. *SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 857 (9th Cir. 2001); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997). Here, Flannery failed to meet this standard because he knew facts that made the letters misleading and yet declined to correct the misleading statements before the letters were sent to investors.

Flannery acknowledged at the July 25 Investment Committee Meeting that "if liquidity [were] siphoned" following the sale of the AAA-rated securities, LDBF would be "stuck with a lower quality portfolio." JA2320. And he knew days after the sale that SSgA's internal advisory groups had recommended that their clients leave LDBF. JA1014-17, 1247-48, 2349-63, 2636-40. Indeed, the internal advisory group clients and Related Funds began redeeming immediately after the sale of the AAA-rated bonds. JA3842-45, 2636-40. Flannery understood,

[9] With respect to Hopkins, the Chamber also does not explain why the sophistication of LDBF investors meant that they would not have considered the misrepresentation of LDBF's ABS holdings in the Typical Portfolio Slide to be important.

therefore, that the practical effect of the sales was to impair LDBF's risk profile. The Commission thus reasonably concluded that "Flannery's subsequent approval of the statement in the August 2 letter that the sales *reduced* risk thus reflects a departure from the 'reasonable care' he owed LDBF investors." ADD103. And Flannery's representation in the August 14 letter that SSgA believed "judicious investors" would remain in LDBF, despite his knowledge that SSgA's internal advisory groups and the Related Funds were redeeming, "evinces only a further departure from that standard." ADD103.

Flannery nonetheless argues that he acted reasonably because he relied on the advice of counsel and that the Commission erred by deeming counsel's role "irrelevant." FlanneryBr.44. But the Commission did no such thing. It recognized that "reliance on counsel 'is not a complete defense, but only one factor for consideration.'" ADD104 n.156 (quoting *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994)). And it found that, "even accepting Flannery's claims that counsel were heavily involved in the drafting of the letters, that does not make his approval and/or drafting of the challenged language reasonable under the circumstances." ADD104. Whether the "statements were true was not a legal judgment but a business one—and one that Flannery was well equipped to make." ADD104. Flannery "did not have to be an attorney to understand that the sale of the AAA-rated securities, followed by massive redemptions, ultimately increased LDBF's

risk," as "he himself made this very observation at the Investment Committee meeting." ADD104. Nor did he require legal advice to understand that "'judicious investors' thought it best to exit the fund, as his own colleagues had told him that they would be advising their clients to redeem their LDBF shares." ADD104; JA1014-18, 1247-48, 2349-63.

Flannery contends that, even if the statements in the letters concerned business judgments, counsel's role nevertheless demonstrates that Flannery acted reasonably because he sought counsel's advice in an effort to make the statements compliant with the securities laws. FlanneryBr.47. Under this view, a businessman could never act unreasonably so long as he sought the advice of counsel. But the presence of counsel does not always preclude negligence. *See Howard v. SEC*, 376 F.3d 1136, 1147-49 (D.C. Cir. 2004); *SEC v. Steadman*, 967 F.2d 636, 642 (D.C. Cir. 1992). Flannery cannot "screen himself by trying to rely on advice of counsel" where he himself knew the relevant undisclosed facts and should have known that the representations in the letters were misleading. *See United States v. King*, 560 F.2d 122, 132 (2d Cir. 1977). Also, Flannery does not explain how counsel's involvement made it reasonable for him, an experienced securities professional, to draft, edit, and approve the misleading statements in the letters despite knowing that SSgA's internal advisory groups and Related Funds were leaving LDBF. As the Commission stated, "that others (including attorneys)

apparently sanctioned the language does not excuse Flannery's decision to do so"—he "still should have appreciated that the letter[s were] misleading." ADD106.

Flannery's arguments that he reasonably believed that each letter conveyed accurate information also necessarily fail in light of the undisclosed facts that he knew. With respect to the August 2 letter, Flannery contends that the Commission erroneously "disregarded the role of knowledgeable executives" who believed that the sale of the AAA bonds reduced risk. FlanneryBr.48-50. To the contrary, the Commission stated that "even if others were 'heavily involved' in its drafting, we find that those facts . . . do not excuse [Flannery's] decision to approve misleading language." ADD105. As it held, "[r]egardless of what others may have thought, [Flannery] had an obligation to exercise his own, independent, judgment." ADD105. "Depending on others to ensure the accuracy of disclosures to purchasers and sellers of securities" is "inexcusably negligent." *SEC v. Shanahan*, 646 F.3d 536, 544 (8th Cir. 2011). Flannery was an experienced securities professional who had an obligation to exercise his own reasonable judgment.

Flannery also contends that the Commission's findings that he made repeated decisions not to change the misleading language in the letter and approved it are "unsupported by [the] record." FlanneryBr.49. But Flannery was sent a draft of the August 2 letter, edited it, and made no changes to the misleading

language (JA2346-48, 2364-67), and he was copied on the final version that was to be sent to clients (JA2368-69, 2375-80). This was substantial evidence for the Commission's conclusion that Flannery made "repeated decisions not to change the language at issue" that "operated as tacit approval of [the letter's] contents." ADD105. These actions were unreasonable because Flannery knew that the sale of the AAA bonds, followed by redemptions, "would leave LDBF with a 'lower quality portfolio'" and that "the very purpose of the sale was to generate liquidity for expected redemptions." ADD103. Flannery "thus should have appreciated that . . . there was a significant danger that, as drafted, the August 2 letter would mislead investors." ADD103.

With respect to the August 14 letter, Flannery argues that his belief that investors should hold their positions in LDBF was reasonable, given the state of the market and given that others shared the same view. FlanneryBr.51. But, as the Commission noted, even "if Flannery himself believed investors should remain invested in LDBF, the statement refers to *SSgA's* belief that investors would do so." ADD100. And it was "undisputed that others at SSgA considered LDBF a poor investment and were exiting the fund." ADD100. Indeed, Flannery knew "at the time that SSgA itself and its internal advisory group clients were redeeming shares in the fund." ADD105 n.160. And he does not explain how it was

reasonable, knowing this, to say that "judicious investors" would remain in the fund.

Finally, Flannery argues that various SSgA personnel reviewed the August 14 letter and "nobody suggested that the 'many judicious investors' language was misleading or should be changed." FlanneryBr.50. But as discussed above, that others reviewed the letter does not mean that Flannery, a senior and experienced securities professional, acted reasonably. ADD106.

4. Flannery's misconduct constituted a course of business that operated as a fraud or deceit on LDBF investors.

As the Commission found, Flannery "helped to draft, edit, and approve at least two letters that had the cumulative effect of misleading LDBF investors about their investments," this conduct "spanned a critical two-week period of market turmoil," and it "encompassed more than one materially misleading communication." ADD106-07. The Commission appropriately found this conduct "sufficient to hold Flannery liable for having engaged in a 'course of business' that operated as a fraud on LDBF investors" in violation of Section 17(a)(3). ADD107; 15 U.S.C. § 77q(a)(3).

Flannery contends that he cannot be liable under Section 17(a)(3) because, in his view, the Commission held that Section 17(a)(3) applies only to those "who *repeatedly* make[] or draft[] [material] misstatements" and, he asserts, he "did not 'make' or draft' the risk reduction language in the August 2 letter."

FlanneryBr.55. He misreads the Commission's opinion. The Commission did not limit liability under Section 17(a)(3) to those who "make" or "draft" a misstatement. Rather, the Commission sought to explain that such conduct plainly falls within the purview of Section 17(a)(3). It stated explicitly that Section 17(a)(3) covers "*all* 'transaction[s], practice[s], and course[s] of business' that 'operate or would operate as a fraud.'" ADD83 (emphasis added). The Commission identified *one* such fraudulent practice or course of business as repeatedly making or drafting material misstatements to investors over a period of time. ADD84. Another would be, for example, where a defendant's negligent misconduct results in investors receiving misleading information. ADD84.

Here, regardless of whether Flannery "drafted" the August 2 and 14 letters, his actions fall squarely within Section 17(a)(3)'s prohibition on courses of business that have the effect of misleading investors. As the Commission found, as a result of the two letters sent over a two-week period that Flannery negligently drafted, edited, and approved, investors received misleading information about the nature of their investments in LDBF. *See* ADD84. Accordingly, he is liable under Section 17(a)(3).

II. The Commission's interpretation of Section 17(a)(3) is correct and, in any event, reflects a reasonable exercise of the Commission's statutory authority to administer Section 17(a) of the Securities Act.

While the Commission's reasonable interpretation of Section 17(a)(3) is correct as an original matter, it is also entitled to deference. Where, as here, Congress has authorized an agency to administer a statutory provision through adjudication (15 U.S.C. § 77h-1), the Supreme Court has instructed that such authorization is a strong "indicator of delegation meriting" judicial deference. *United States v. Mead Corp.*, 533 U.S. 218, 229 (2001); *City of Arlington v. FCC*, 133 S.Ct. 1863, 1874 (2013); *see also SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) (deferring to the Commission's interpretation of Exchange Act Section 10(b) in an adjudicatory decision).

When determining whether deference is appropriate in a particular case, a court asks, first, "whether the statutory text forecloses the agency's assertion of authority." *City of Arlington*, 133 S. Ct. at 1870-71. If not—if the statute is "ambiguous with respect to the specific issue," *id.* at 1868—the Court "defer[s] to the agency's reasonable interpretation," *P. Gioioso & Sons, Inc. v. Occupational Safety & Health Review Comm'n*, 675 F.3d 66, 72 (1st Cir. 2012). Here, the Commission's interpretation of Section 17(a)(3) follows directly from—and thus is neither foreclosed by nor reflects an unreasonable interpretation of—the statutory text.

1. The Commission based its interpretation of Section 17(a)(3) on the statute's plain language. As the Commission explained, Section 17(a)(3) prohibits negligent "practice[s]" and "course[s] of business"—including, but not limited to, the making, drafting, and dissemination of misstatements—that would operate as a fraud on investors. ADD83-84; 15 U.S.C. § 77q(a)(3). The ordinary meaning of the terms "practice" and "course of business" denotes *any* routine, customary, or repeated conduct. *See* Webster's New Int'l Dictionary 1937 (2d ed. 1934) (defining "practice" as any "performance or application habitually engaged in" or "repeated or customary action"); *id.* at 610 (defining "course," as used as in "course of conduct" to mean "a succession of acts or practices"); *accord United States v. Jones*, 57 F.3d 1020, 1024 (11th Cir. 1995) (defining "practice" as "the 'performance or operation of something,' 'performance or application habitually engaged in,' or 'repeated or customary action'").

Flannery's primary argument to the contrary (Br.59-61) is premised on a reading of Section 17(a)*(2)*; he does not engage with the text of Section 17(a)*(3)* other than to assert that it necessarily excludes any conduct covered by Section 17(a)(2). Indeed, he offers no reason why a series of misstatements would *not* constitute a "practice" or "course of business" that could "operate as a fraud" on investors. Rather, Flannery insists that because only Section 17(a)(2) specifically references misstatements, all misstatement-related conduct is necessarily the

exclusive province of that subsection. FlanneryBr.59-61. But in so arguing, he misreads the Supreme Court's decision in *United States v. Naftalin*, 441 U.S. 768 (1979).

In *Naftalin*, and then again in *Aaron*, the Supreme Court explained that each subsection of Section 17(a) "proscribes a distinct category of misconduct. Each succeeding prohibition is meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections." *Naftalin*, 441 U.S. at 774; *Aaron*, 446 U.S. at 696-97. Flannery seizes on the phrase "distinct category" to assert that the subsections must be mutually exclusive. But he misses the Court's point: that the subsections are successively broader in scope and should not be read to limit one another. Moreover, Flannery fails to appreciate that his reading of the statute would cause Section 17(a)(2) to impermissibly "narrow the reach of" Section 17(a)(1)—it would excise from its scope any "device, scheme or artifice to defraud" involving a misstatement or omission. 15 U.S.C. § 77q(a)(1). That is precisely what *Naftalin* and *Aaron* prohibit.

The Commission's interpretation of Section 17(a)(3), by contrast, fully comports with *Naftalin* and *Aaron*. Reading Section 17(a)(3) to encompass negligent misstatements in no way "narrow[s] the reach of the prior sections." *Naftalin*, 441 U.S. at 774. Rather, the Commission's interpretation enables each subsection to proscribe "additional kinds of illegalities" not covered by the one

before it. *Id.* It is thus consistent with the statutory structure the Supreme Court seemed to envision in *Aaron*: overlapping subsections that become sequentially broader in scope as they move from scienter-based fraud (Section 17(a)(1)) to non-scienter-based conduct that does or "would" defraud investors (Sections 17(a)(2) and (a)(3), respectively). *Aaron*, 446 U.S. at 696-97.

Flannery argues that such a reading renders Section 17(a)(2) "meaningless." FlanneryBr.61. But he also concedes, as he must, that a single negligent misstatement would not constitute a "practice" or "course of business" and thus could be charged under *only* Section 17(a)(2) (provided the defendant obtained money or property), and not Section 17(a)(3). And, in any event, the Commission has long held that the subsections of Section 17(a) are "mutually supporting," *not* "mutually exclusive." *Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 60638, at *4 (Nov. 8, 1961).

2. Although it understood its interpretation to follow largely from the statute's plain text, the Commission also recognized that courts have disagreed about the scope of Section 17(a). ADD70. As to Section 17(a)(3), in particular, courts have differed as to whether it encompasses liability for negligent misrepresentations. *Compare, e.g.*, *SEC v. Goldsworthy*, No. 06-10012, 2008 WL 8901272, at *12 (D. Mass. June 11, 2008) (Section 17(a)(3) claims "were properly

predicated upon misstatements") *with SEC v. Stoker*, 873 F. Supp. 2d 605, 614 (S.D.N.Y. 2012) (Section 17(a)(3) claims must go "beyond" misrepresentations).

To the extent it too finds the statute ambiguous, this Court should defer to the Commission's reasonable interpretation of Section 17(a)(3). As noted, that Congress provided for a formal adjudicative process for administering the Securities Act is itself indicative of congressional "delegation meriting *Chevron* treatment." *Mead*, 533 U.S. at 229-30. And the Supreme Court has, accordingly, deferred to the Commission's interpretation in adjudicatory decisions of other antifraud provisions of the securities laws. *Zandford*, 535 U.S. at 819-20.

Flannery argues, however, that the Commission's interpretation of Section 17(a)(3) is *not* entitled to deference because it "was never argued by the Division" or "raised by the Commission at oral argument" and thus "is devoid of the adversarial procedural safeguards required for deference." FlanneryBr.63-64. That argument fails because, as the Supreme Court has explained, it is the formality of the adjudicative process itself—not the nature of the arguments made—that makes deference to agency decisions appropriate. *See City of Arlington*, 133 S.Ct. at 1874; *Mead*, 533 U.S. at 228-30, 234-38. Merely because Flannery disagrees with the end *result* of that process does not mean that deference is less warranted. Indeed, it would turn on its head the entire justification for deference—the presumption that statutory ambiguity constitutes an implicit

delegation of interpretive authority to an agency, *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984)—to hold that the degree of deference somehow turns on how closely the agency hews to the parties' litigating positions.[10]

III. Application of the Commission's interpretation of Section 17(a)(3) does not contravene principles of fair notice or the rule of lenity.

A. Flannery did not lack fair notice of Section 17(a)(3)'s prohibitions.

Flannery contends that "applying the Commission's interpretation to [him] would violate his due process right to fair notice," because his conduct occurred before the Commission clarified the scope of liability under Section 17(a)(3). FlanneryBr.60, 63-65. That argument also fails.

The "fair notice" doctrine forecloses agency action only in the "very limited set of cases" where the agency's interpretation is "so far from a reasonable person's understanding of the [statute] that [it] could not have fairly informed [the person] of the agency's perspective." *Suburban Air Freight, Inc. v. TSA*, 716 F.3d 679, 684 (D.C. Cir. 2013) (internal quotation marks omitted). Here, the Commission's interpretation of Section 17(a)(3) is not "so far from" what a reasonable person might expect the statute to mean that, as Flannery claims

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[10] This Court's decision in *SEC v. Tambone* is not to the contrary. 597 F.3d 436, 449 (1st Cir. 2010). There, the Court declined to defer to the Commission's position because, in that case—in contrast to the present one— the Commission's position was developed in litigation, not through a formal adjudicative process. *Id.*

(Br.63), "nobody was on notice" that the Commission would read the provision to encompass misleading misrepresentations and omissions. As discussed above, the Commission's interpretation is driven primarily by the literal text of the statute. It seems improbable, to say the least, that "a reasonable person" would not have expected the statute to be read literally. Moreover, over the past two decades, multiple courts and Commission decisions have held that misstatement-related conduct may give rise to liability under Section 17(a)(3).[11]

Therefore, even if "the outer contours of liability under Section 17(a)(3)" were—and remain—unclear, *Anthony Fields*, Securities Act Release No. 9727, 2015 WL 728005, at *10-11 (Feb. 20, 2015), it is *not* the case that the provision's application to Flannery's conduct was (or is) unclear. Flannery, a 30-year veteran of the securities industry (FlanneryBr.65) should have appreciated that repeatedly

[11] For judicial decisions, *see*, *e.g.*, *Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006) (misrepresentations in documents sent to prospective investors); *SEC v. Seghers*, No. 04-cv-1320, 2006 WL 2661138, at *3 (N.D. Tex. Sept. 14, 2006) (misleading letters to investors), *aff'd in relevant part*, 298 F. App'x 319 (5th Cir. 2008); *SEC v. Melchior*, No. 90-c-1024J, 1993 WL 89141, at *16, 21 (D. Utah Jan. 14, 1993) (same); *see also SEC v. Banc of Am. Mortg. Sec., Inc.*, No. 13-cv-00447, 2014 WL 2778498, at *4 (W.D.N.C. June 19, 2014) (slip op.); *Goldsworthy*, 2008 WL 8901272, at *8. For Commission decisions, *see, e.g.*, *Johnny Clifton*, Securities Act Release No. 9417, 2013 WL 3487076, at *10 (July 12, 2013) (misleading "misrepresentations and omissions" in investor communications); *Piper Capital Mgmt., Inc.*, 56 S.E.C. 1033, 2003 WL 22016298, at *9 (Aug. 26, 2003) ("participation" in "materially misleading disclosure" documents); *Byron G. Borgardt*, 56 S.E.C. 999, 2003 WL 22016313, at *13 (Aug. 25, 2003) (omissions in registration statements); *Nat'l P'ship Invs. Corp.*, Securities Act Release No. 7425, 1997 WL 349021, at *5–6 (June 25, 1997) (misleading statements in public filings).

editing, drafting, and approving misleading letters to investors would fall squarely within Section 17(a)(3)'s prohibition on "course[s] of business" that operate as a fraud upon investors. As the Supreme Court has advised, where a statute's prohibitions "are set out in terms that the ordinary person exercising ordinary common sense can sufficiently understand and comply with," and the conduct at issue "falls squarely within the 'hard core' of the statute's proscriptions," it is no defense that "the outermost boundaries of [the statute] may be imprecise." *Broadrick v. Oklahoma*, 413 U.S. 601, 608 (1973).

The authority Flannery cites in support of his fair notice claim also is inapposite here, where the Commission's opinion is consistent with its past pronouncements and follows directly from the statutory text. This case therefore is unlike *FCC v. Fox Television Stations, Inc.*, in which the FCC impermissibly "changed course" and significantly altered what it deemed to be the "key consideration[s]" for establishing statutory violations. 132 S. Ct. 2307, 2317-18 (2012). This case is also distinguishable from *Upton v. SEC*, where, after years of minimal enforcement of one of its rules, the Commission made "a substantial change in its enforcement policy," broadly construing the rule to prohibit conduct that actually complied with its literal language. 75 F.3d 92, 97-98 (2d Cir. 1996).

B. The rule of lenity is inapplicable.

Flannery and the Chamber argue erroneously that because Section 17(a)(3) may be used as the basis for both civil and criminal liability (15 U.S.C. § 77x), the rule of lenity requires that that it be read to exclude any misstatement-related conduct. FlanneryBr.62-63; ChamberBr.13-21. As this Court has explained, "the rule of lenity is rarely applied, and should be reserved for situations in which, 'after considering text, structure, history, and purpose, there remains a grievous ambiguity or uncertainty in the statute such that the Court must simply guess as to what Congress intended.'" *United States v. Fernandez*, 722 F.3d 1, 26 n.15 (1st Cir. 2013) (quoting *Barber v. Thomas*, 560 U.S. 474, 488 (2010)). "The simple existence of *some* statutory ambiguity . . . is not sufficient to warrant application of [the rule], for most statutes are ambiguous to some degree." *Muscarello v. United States*, 524 U.S. 125, 138–39 (1998) (emphasis added); *United States v. Jimenez*, 507 F.3d 13, 20-21 (1st Cir. 2007).

Here, to the extent Section 17(a)(3) is ambiguous—and remains so after considering the statute's "context, structure, history, and purpose," *Abramski v. United States*, 134 S. Ct. 2259, 2272 n.10 (2014)—such ambiguity is certainly not "grievous." Tellingly, neither Flannery nor the Chamber asserts that it is. *See* FlanneryBr.62-63; ChamberBr.13-21. Their argument must be, therefore, that—as others before them have unsuccessfully claimed—the rule applies "because it [i]s

possible to articulate a construction more narrow than that urged by the Government." *See Soto-Hernandez v. Holder*, 729 F.3d 1, 6 (1st Cir. 2013) (quoting *Moskal v. United States*, 498 U.S. 103, 108 (1990)). But that argument fails; as noted above, the Supreme Court has "repeatedly emphasized that is not the appropriate test." *Abramski*, 134 S. Ct. at 2272 n.10. Moreover, even if one were to find some meaningful ambiguity in the statute, generally, it certainly is not ambiguous as to *Flannery*; as discussed, his conduct falls squarely within the heartland of its prohibitions. Surely, as an experienced securities professional, Flannery could not have reasonably believed that it was permissible to disseminate misstatements to investors. The rule of lenity is therefore simply inapposite in this case.

The Chamber nevertheless endeavors to set up a conflict between principles of administrative deference and the rule of lenity, arguing that lenity must always trump deference to an agency's interpretation of a statute. ChamberBr.13-21. But this Court has rejected the Chamber's position, holding that when a statute is ambiguous, it is appropriate to first defer to the agency interpretation before determining whether resort to the rule of lenity is required. *Perez-Olivo v. Chavez*, 394 F.3d 45, 53 (1st Cir. 2005) ("[T]he rule of lenity does not foreclose deference to an administrative agency's reasonable interpretation of a statute."); *Soto-Hernandez*, 729 F.3d at 6 ("Especially in light of the deference owed to the BIA's

constructions of [the statute], the rule of lenity cannot apply to contravene the BIA's reasonable interpretation in this case."). And, in any event, the conflict the Chamber attempts to create is illusory here, where Section 17(a)(3) is not "grievous[ly]" ambiguous, and thus the rule of lenity is inapplicable. Accordingly, even if one were to accept the Chamber's argument, deference to the Commission's reasonable interpretation of Section 17(a)(3) is still appropriate here.

IV. The Commission properly exercised its discretion when sanctioning Flannery.

"A sanctions order of the Commission must be upheld unless the order is a gross abuse of discretion." *Rizek v. SEC*, 215 F.3d 157, 160 (1st Cir. 2000) (internal quotation marks omitted). Because the "appropriate remedy is 'peculiarly a matter for administrative competence,'" *id.*, "[c]onsiderable deference should be given the Commission's ultimate judgment about what will best protect the public," *id.* at 161 (internal quotation marks omitted). "As a result, the Commission's sanctions must be affirmed unless unwarranted in law or . . . without justification in fact." *Id.* at 160 (internal quotation marks omitted).

Here, the Commission appropriately exercised its discretion when it determined to impose a one-year suspension, a cease-and-desist order, and a $6,500 penalty on Flannery. *See* ADD109-16. In making that determination, the Commission did not "fail[] to explain how" the applicable factors supported those

sanctions, nor did it erroneously apply the factors, as Flannery suggests. FlanneryBr.65. To the contrary, as sort forth in detail in its opinion, the Commission specifically considered, and appropriately applied, each of the applicable guiding factors. ADD109-16.

Flannery notes his "impeccable 30-year career in the industry," his "sterling character," and "the age of the conduct." FlanneryBr.65. But the Commission accounted for these factors when determining to impose only a "lenient" one-year suspension and the minimum statutory penalty. ADD111-16. And, aside from his disagreement with the Commission's assessment of the seriousness of his misconduct and the risk of future violations, Flannery identifies no other purported errors in the Commission's analysis. As a result, he fails to demonstrate that the Commission abused its discretion when sanctioning him.

CONCLUSION

For the foregoing reasons, the Commission's order should be affirmed.

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitation set forth in Federal Rule of Appellate Procedure 32(a)(7)(B) because, according to the word processing program with which it was prepared (Word 2010), the brief contains 13,980 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

I also certify that this brief complies with the typeface and type-style requirements of Federal Rule of Appellate Procedure 32(a)(5) and (6) because it uses a proportionally spaced, 14-point typeface.

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CERTIFICATE OF SERVICE

I certify that on July 15, 2015, I electronically filed the foregoing Brief of the Securities and Exchange Commission, Respondent, using the Court's CM/ECF system, and that the following counsel of record will be served by the Court's CM/ECF system:

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