Nos. 15-1080, 15-1117

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

JOHN P. FLANNERY,

Petitioner,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

JAMES D. HOPKINS,

Petitioner,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For Review of an Order of the
United States Securities and Exchange Commission

BRIEF FOR AMICUS CURIAE THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONERS AND VACATUR

KATE COMERFORD TODD
STEVEN P. LEHOTSKY
U.S. CHAMBER LITIGATION CENTER, INC.
1615 H Street NW
Washington, DC 20062
(202) 463-5337

JONATHAN G. CEDARBAUM
CHRISTOPHER DAVIES
DANIEL AGUILAR
JOHN BYRNES
WILMER CUTLER PICKERING HALE AND DORR LLP
1875 Pennsylvania Avenue NW
Washington, DC 20006
(202) 663-6000

June 15, 2015

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 29 and 26.1(a), amicus curiae the Chamber of Commerce of the United States of America states that it is not a subsidiary of any corporation, and no publicly held corporation owns 10% or more of its stock.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

CASES

DOCKETED CASES

CODES AND REGULATIONS

OTHER AUTHORITIES

STATEMENT OF INTEREST

The Chamber of Commerce of the United States of America submits this brief with the consent of all parties.[1] The Chamber is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than 3 million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts, including this Court. To that end, the Chamber regularly files amicus curiae briefs in cases that raise issues of concern to the nation's business community.

The Chamber has a strong interest in the proper resolution of this case. The Chamber's members include many companies that make statements that may influence investors' investment decisions. In determining whether such statements are material for purposes of the securities laws, courts should consider both whether the statements were made in face-to-face or open-market settings and the investors' degree of sophistication. In addition, the Chamber's members are subject to many federal statutes that, like § 17(a) of the Securities Act of 1933,

---

[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from *amicus curiae*, its members, and its counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

impose both civil and criminal liability. Those statutes must have clear and readily understandable meanings in order for businesses to ensure that they abide by them.

SUMMARY OF ARGUMENT

In this SEC proceeding, the Commission failed, in assessing the materiality of the allegedly misleading statements and omissions, to consider two crucial aspects of the context in which the statements were made. State Street Global Advisors (SSgA) made communications that were (i) direct and personal to a small group of investors rather than an open-market transaction and (ii) to institutional investors and professional advisors. Under circumstances like these—involving face-to-face transactions and sophisticated investors—courts have properly recognized what the Commission did not: because a "reasonable investor" in this type of transaction has more information than someone who transacts on the open market, the government must satisfy a higher threshold of materiality to demonstrate that the alleged misstatement or omission would "significantly alter" the "total mix" of information. The Chief Administrative Law Judge (CALJ) conducted the correct analysis, addressing whether investors in the Limited Duration Bond Fund (LDBF) were able to request more information and crediting testimony that a sophisticated investor would not have considered the alleged misinformation as material. The Commission's conclusory and acontextual determination that the communications were material capriciously ignored the proper elements of materiality and should be rejected.

The Commission also asserted a novel and expansive interpretation of § 17(a)(3) of the Securities Act of 1933 in this proceeding, imposing liability where it had not been contemplated before. The Court should reject the Commission's newly minted reading of a decades-old statute. Even if § 17(a)(3) could conceivably support the Commission's reading, that provision is certainly not so clear as to escape the rule of lenity's command that ambiguity must be resolved in the defendant's favor. Although courts typically apply the rule of lenity in criminal prosecutions, it is well settled that the rule applies in civil cases as well where, as is true here, the statute in question may support either criminal or civil liability. Applying the rule of lenity to hybrid statutes of this sort promotes consistent interpretation of the law, fair notice to the public of what the law requires, and clear boundaries between the branches of government. Congress has entrusted the Commission with responsibility to administer the Securities Act, but the Commission's construction of § 17(a)(3) is not entitled to deference under *Chevron USA, Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Because of § 17(a)(3)'s hybrid character, any uncertainty in its meaning must be resolved in favor of the defendant rather than in favor of the Commission's interpretation.

ARGUMENT

I. THE COMMISSION'S MATERIALITY ANALYSIS FAILED TO CONSIDER THE CONTEXT OF THE TRANSACTION, WHICH INVOLVED DIRECT DEALINGS WITH SOPHISTICATED INVESTORS

A. Materiality Requires A Context-Specific Inquiry

The Commission used an inappropriate legal standard when it determined that certain alleged misstatements and omissions in a PowerPoint presentation (the "Typical Portfolio Slide") and two investor letters (the August 2 and August 14 letters) were material. The Commission held that the allegedly misleading statements were material because their materiality should be measured using a hypothetical reasonable investor without considering the information available to LDBF's typical clients or their sophistication and because the "investors … were not necessarily uniformly knowledgeable about fixed income investing." Order 44.

An alleged misstatement's materiality "is an objective" question, which requires "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445, 450 (1976). Thus, information is material only when there is "a substantial likelihood that … [it] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 449. Accordingly, fact-finders must consider "all relevant circumstances" in determining an alleged misstatement or omission's materiality. *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 197 (2d Cir. 2009).

In this proceeding, the SEC failed to take account of several of those relevant circumstances. *First*, the "total mix" of information available will depend on what background a reasonable investor has about the situation, what information is readily accessible, and what diligence is ordinarily conducted. *See, e.g.*, *Starr ex rel. Estate of Sampson v. Georgeson S'holder, Inc.*, 412 F.3d 103, 110 (2d Cir. 2005) (holding that letter was not materially misleading because plaintiff could have understood its meaning with "minimal diligence"). *Second*, the "reasonable investor" is not a fixed concept because the facts known to that hypothetical investor and the inferences to be drawn from those facts depend on and take into account the context of the alleged misstatement or omission. *See, e.g.*, *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1319 (2011) (in case involving pharmaceutical business, the court analyzed what inferences "medical experts" would draw from the omitted information in determining what a reasonable investor would conclude). *Third*, the facts and inferences that the reasonable investor will consider "significant" will vary with the type of transaction at issue and its purpose. *See, e.g.*, *Walter v. Holiday Inns, Inc.*, 985 F.2d 1232, 1239 (3d Cir. 1993) (in partnership buy-out context, materiality analysis considers "the sophistication of the complaining partner and the degree of access to partnership records"); *Titan Grp., Inc. v. Faggen*, 513 F.2d 234, 239 (2d Cir. 1975) (holding in acquisition context that "[w]hile the omissions might, in other circumstances, have been deemed material, the omissions were not material in these circumstances"); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 239 (1988) (setting forth factors for determining materiality in merger context, including "indicia of interest in the transaction at the highest corporate levels," "the size of the … corporate entities," or "potential premiums over market value").[2]

B. The Commission Failed To Consider The Difference Between Face-To-Face And Open-Market Transactions

In the context of face-to-face transactions—or other transactions involving a limited number of investors directly interacting with their counterparties—a "'looser or more subjective' test for materiality is proper." *Grigsby v. CMI Corp.*, 765 F.2d 1369, 1372-73 (9th Cir. 1985) (*citing Thomas v. Duralite Co*., 524 F.2d 577, 584 (3d Cir. 1975)). Whereas investors who transact in the open market might rely on publicly available information, investors who interact with their counterparties in private transactions often have access to better information. *See*,

---

[2] In an analogous tort law context, actors must conform to the standard of conduct of a "reasonable man *under like circumstances*" to avoid being negligent. Restatement (Second) of Torts § 283 (emphasis added). In its own Rules of Practice, the Commission similarly explains that an auditor's independence from its client will be assessed on the basis of whether a "reasonable investor with knowledge of all relevant facts and circumstances" would consider the auditor independent. 17 C.F.R. § 210.2-01(b).

e.g., *Pittsburgh Coke & Chem. Co. v. Bollo*, 560 F.2d 1089, 1091-92 (2d Cir. 1977) (finding no material misstatement where investor "had unrestricted access to [company's] basic business data … [and] books and records"). Even when they do not in fact have better information, they are often able to request more information—just as LDBF's investors could have requested detailed information from their relationship managers. *Compare* CALJ Op. 9, 34 (investors "asked a lot of questions" and "got answers" from SSgA) *with Titan Grp.*, 513 F.2d at 238 (finding no material omission where investor had "long opportunity to examine the financial status of the … companies prior to closing the deal"). Thus, when investors have access to their counterparties, they typically have access to more information, making it more difficult for a misstatement or omission to "significantly alter" the "total mix" of information available.

Because courts expect investors with direct access to do more with the information they have and to gather more information when appropriate, the materiality of information in the hands of such investors is subject to more searching inquiry. Unlike open-market investors, who rely on the market to "perform[] a substantial part of the valuation process," *Basic*, 485 U.S. at 244, such investors are expected to become familiar with the facts and to make an independent assessment of the investment opportunity. *See, e.g.*, *Cowles v. Dow Keith Oil & Gas, Inc.*, 752 F.2d 508, 512 (10th Cir. 1985) (failure to disclose geological data not material, because investors had "about as much means of acquiring information and knowledge as did the defendant"). As a result, when investors fail to exercise adequate diligence, allegedly misleading statements and omissions will be found immaterial. *See, e.g.*, *Milton v. Van Dorn Co.*, 961 F.2d 965, 972 (1st Cir. 1992) (in capital stock purchase transaction, undisclosed information about business plan held not to be material, because purchaser failed to request more information about the plan).

In this case, the LDBF's clients—a relatively limited group of institutional investors—received their communications either in letters or during in-person presentations. *See* CALJ Op. 5, 9. As the co-head of Relationship Management at SSgA explained, "any institutional client would know that it could seek information … beyond what its assigned relationship manager provided." CALJ Op. 9. Unlike open-market transactions involving anonymous transactions among parties that do not know one another, *Basic*, 485 U.S. at 243-44, transactions in the LDBF were more direct and personal—aligning more closely with the "face-to-face transactions contemplated by early fraud cases." *Id.*

The CALJ properly noted both investors' access to "plenty of evidence" from SSgA and the fact that the investors were able to "get the information they want." CALJ Op. 34. In addition, in reviewing the materiality of a March 2007 letter, the CALJ found statements that indicated "a willingness to provide more information upon request." CALJ Op. 50. By contrast, the Commission erroneously dismissed the ready availability of clarifying information as irrelevant and asserted without any citation to the record that LDBF's clients might not have been experienced in fixed-income investing. Order 29, 31. This approach—in which the Commission disregarded or distinguished away the relevant context—is incorrect as a matter of law and should be rejected.

C. The Commission Failed To Consider The Sophistication Of LDBF's Investors

The Commission's materiality analysis was also legally flawed because it failed to take the typical level of LDBF investors' sophistication into account. As this Court has explained, a proper materiality analysis considers whether the allegedly misleading statements or omissions would have altered significantly the information available to a "reasonable investor *in his posture*." *SEC v. Happ*, 392 F.3d 12, 23 (1st Cir. 2004) (emphasis added). That contextual approach necessarily takes into account the inferences that a sophisticated investor might draw from the available information. *See id.* at 21-22 (because member of a company's board of directors "was a financial expert and had closely followed the affairs" of the company, he was able to draw material inferences from general concerns about company's "difficulties").[3] Thus, when an investment product is offered only to sophisticated investors who are advised by experienced money managers, the fact-finder must look to the "total mix" of information available to similarly situated investors. *See*, *e.g.*, *Wu v. Stomber*, 883 F. Supp. 2d 233, 238, 260 (D.D.C. 2012) (in case involving RMBS investment products "made available only to a restricted group of sophisticated, wealthy investors," there was no omission of material facts, "[g]iven the highly sophisticated investors and the unambiguous disclosures contained in the Offering documents"), *aff'd*, 750 F.3d 944 (D.C. Cir. 2014); *see also Nashery v. Carnegie Trading Grp., Ltd.*, 242 F. App'x 318, 323 (6th Cir. 2007) (in Commodities Exchange Act case, no material misstatement where investors were "educated, sophisticated businessmen" who "read and signed statements explaining the inherent risks involved in these types of financial transactions").

Courts regularly consider investor characteristics and their actual behavior in the circumstances when they assess whether information would be material to a "reasonable investor." Indeed, the behavior of market participants is "'the only

[3] As with all materiality determinations, the effect of investor sophistication depends on the context. In insider trading cases, sophistication might actually lower the threshold for materiality, because a sophisticated insider might draw material inferences from information that might appear immaterial or commonplace to a less experienced investor. *See Happ*, 392 F.3d at 23.

truly objective evidence of the materiality.'" *SEC v. Shapiro*, 494 F.2d 1301, 1307 (2d Cir. 1974) ("The behavior of appellant, his partner Shapiro, and others who knew of the merger, all of whom were sophisticated investors, demonstrates empirically that the information was material."). Courts also rely on expert testimony to understand the materiality of information in the context of the transaction at issue. *See, e.g.*, *First Marblehead Corp. v. House*, 541 F.3d 36, 41-42 (1st Cir. 2008) (relying on expert testimony to explain that given the "uncertainty surrounding [the company's] financial future, it would not have made financial sense for someone in [the plaintiff's] position to exercise the options."); *United States v. Reyes*, 577 F.3d 1069, 1075-76 (9th Cir. 2009) (expert identified figures that "he, as a reasonable investor, would want to know when he made his investment decisions").

The CALJ thoughtfully conducted such a contextual analysis of the statements at issue here. In rejecting the Division's allegations that the "Typical Portfolio Slide" was a material misstatement by Hopkins, for example, the CALJ observed that LDBF's strategies were "well known in the financial community"; relied on expert opinion that "no sophisticated investor would rely on this single piece of information … before making an investment decision"; and noted the failure of any LDBF investor to request further information about LDBF's actual portfolio composition. CALJ Op. 46. By contrast, the Commission declared the

"Typical Portfolio Slide" to be material without citing any support that investors would have cared about LDBF's exposure to subprime in early 2007. Order 28.[4] Not only did the Commission ignore the expert testimony in the record, but it disregarded the fact that when some investors learned of the risk profile, they did not immediately redeem their shares. Instead, the Commission simply recited the bare legal standard that materiality does not require proof that disclosure would have caused a change in behavior. Order 28. Likewise, the Commission's analysis of the August 2 and 14 letters involving Flannery was conclusory and outcome-oriented, and the Commission failed to address the "total mix" of information available to a reasonable investor in LDBF.

The proper legal standard is that information is material to investors in a particular product only when it would substantially change their thinking about the investment, in light of all relevant facts and circumstances. In this case, the SEC arbitrarily ignored two of those relevant circumstances: the face-to-face rather than open-market nature of the transactions and the investors' level of sophistication. LDBF's clients were experienced investors that "had every opportunity to familiarize [themselves] with [LDBF's] business situation"; the

[4] Materiality must be viewed "from the perspective of a reasonable investor at the time of the misrepresentation, not from the perspective of a reasonable investor looking back on how events unfolded." *Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 831 (8th Cir. 2003).

misleading information identified by the Commission was simply not significant enough to affect the large volume of information LDBF's clients already had available. *Pittsburgh Coke*, 560 F.2d at 1092. The Court should reject the Commission's Order and ensure that the securities laws are enforced in light of actual market expectations.[5]

II. THE RULE OF LENITY REQUIRES THAT THE COMMISSION'S INTERPRETATION OF § 17(A)(3) CANNOT STAND

The Commission imposed civil penalties and a year-long suspension against petitioner Flannery for two alleged misstatements to investors. It did so based on its conclusion that those statements violated § 17(a)(3)'s prohibition on "any transaction, practice, or course of business" that operates as a "fraud or deceit." For the reasons advanced in Flannery's opening brief, § 17(a)'s plain language forecloses the SEC's expansive reading of § 17(a)(3). Flannery Br. 56-62. But even if § 17(a)(3) were ambiguous, the rule of lenity would dictate that any uncertainty in §17(a)(3)'s meaning be resolved in Flannery's favor.

---

[5] It is unnecessary to remand this case for the Commission to consider the correct materiality standard. "[T]he record is fully developed" and the Court "can determine on appeal whether the evidence supports the [Commission's] decision under the appropriate test." *Ward v. Commissioner*, 211 F.3d 652, 656 (1st Cir. 2000).

A. The Rule Of Lenity Applies To § 17(a)(3)

In its most familiar form, the rule of lenity mandates that "where there is ambiguity in a criminal statute, doubts are resolved in favor of the defendant." *E.g.*, *United States v. Bass*, 404 U.S. 336, 348 (1971). Although the rule of lenity is most often applied in criminal cases, the Supreme Court has made clear that the rule applies equally in civil cases when a court is confronted with a hybrid civil-criminal statute, that is, one that establishes a prohibition that may be enforced either civilly or criminally. *See, e.g.*, *Leocal v. Ashcroft*, 543 U.S. 1, 11-12 n.8 (2004) (explaining that, if a statute has criminal applications, "the rule of lenity applies" to the Court's interpretation of the statute even in immigration cases "[b]ecause we must interpret the statute consistently, whether we encounter its application in a criminal or noncriminal context"); *see also Clark v. Martinez*, 543 U.S. 371, 380-381 (2005). The Court articulated this principle over 50 years ago, when it rebuffed the government's argument that a statute with both civil and criminal applications could have "one construction for the [administering agency] and another for the Department of Justice." *FCC v. American Broadcasting Co.*, 347 U.S. 284, 296 (1954). A hybrid statute must "be construed strictly" against the government even in a civil case because "the same construction would likewise apply in criminal cases." *Id.*; *see also Clark*, 543 U.S. at 382 (rejecting the notion that a federal statute is "a chameleon, its meaning subject to change" depending on the procedural posture of a case).

Since its decision in *American Broadcasting Co.*, the Supreme Court has consistently applied the rule of lenity to hybrid statutes, regardless of whether the need to interpret the statute arises in a criminal or civil proceeding. In *Commissioner v. Acker*, 361 U.S. 87, 91 (1959), for example, the Court applied the rule of lenity in interpreting a tax statute in a civil tax proceeding. In *Leocal v. Ashcroft*, 543 U.S. 1 (2004), the Court similarly applied the rule of lenity to 18 U.S.C. § 16's definition of "crime of violence," even though the question arose in a civil immigration proceeding, rather than in a prosecution. *Id.* at 11-12 n.8. In *United States v. Thompson/Center Arms Co*., 504 U.S. 505 (1992), the Court again applied the rule of lenity to "a tax statute … in a civil setting" because the statute also had "criminal applications." *Id.* at 517 (plurality op.).[6] The *Thompson/Center* plurality rejected the dissent's contention that the rule of lenity applied only in criminal prosecutions. It explained that lenity "is a rule of statutory construction whose purpose is to help give authoritative meaning to statutory language. It is not

6 The Bureau of Alcohol Tobacco and Firearms construed the parts of the National Firearms Act that were at issue in *Thompson/Center* to mean that a kit containing a pistol, barrel, and stock constituted a working rifle. 504 U.S. at 508. Under the Bureau's interpretation, the maker of that kit had to pay a tax. *Id.* at 506-507. Relying on the rule of lenity, the Court rejected the Bureau's reading. *Id.* at 517-518.

a rule of administration calling for courts to refrain in criminal cases from applying statutory language that would have been held to apply if challenged in civil litigation." *Id.* at 518 n.10 (internal quotation marks and citations omitted). Justices Scalia and Thomas concurred with the plurality and explicitly agreed that the statute was "sufficiently ambiguous to trigger the rule of lenity." *Id.* at 519.

The courts of appeal have also consistently recognized that the rule of lenity applies to hybrid statutes in civil proceedings. *See Schwartz v. Romnes*, 495 F.2d 844, 848-849 (2d Cir. 1974); *WEC Carolina Energy Solutions LLC v. Miller*, 687 F.3d 199, 204 (4th Cir. 2012) ("Where, as here, our analysis involves a statute whose provisions have both civil and criminal application, our task merits special attention because our interpretation applies uniformly in both contexts."); *In re Woolsey*, 696 F.3d 1266, 1277 (10th Cir. 2012) (for hybrid statutes, "the rule of lenity must apply equally to civil litigants to whom lenity would not ordinarily extend."); *Bingham, Ltd. v. United States*, 724 F.2d 921, 924-925 (11th Cir. 1984) (the rule of lenity applies "even though we construe the OCCA in a declaratory judgment action, a civil context.").

The rule of lenity governs here because § 17(a)(3) may be used as the basis for both criminal and civil liability. *See* 15 U.S.C. § 77x (criminalizing the conduct prohibited by § 17(a) and other sections with a maximum five-year prison sentence and monetary fines).[7]

By consistently applying the rule of lenity in civil as well as criminal proceedings, courts ensure that the rule's laudable goals are reliably advanced. The rule's first goal is to ensure that "a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed." *Bass*, 404 U.S. at 348 (internal quotation marks omitted). This is a matter of due process. An ordinary citizen ought to be able to tell from reading a statute exactly what is prohibited. If the public lacks that fair notice, then the agency should not be permitted to enforce its reading of the law's vagaries. *See FCC v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012); *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2167 (2012) (avoiding result that would cause defendants "unfair surprise").

---

[7] In this case, the Commission imposed a monetary penalty on Flannery and forbade him from associating with any investment advisors or companies for a full year. Order 52. Although civil, these penalties have a quasi-criminal character because they "clearly resemble punishment in the ordinary sense of the word" and the associational bar will likely "have longer-lasting repercussions on [his] ability to pursue [his] vocation." *Johnson v. SEC*, 87 F.3d 484, 488-489 (D.C. Cir. 1996). More generally, the SEC's enforcement powers under § 17(a) can result in "the loss of one's business or livelihood, the loss of benefits that would otherwise be available under the securities laws, and in many cases, the loss of personal and professional reputation," Andre, *The Collateral Consequences of SEC Injunctive Relief*, 1981 U. Ill. L. Rev. 625, 626-627.

Fair notice is particularly important for parties in an industry such as the securities business. Securities industry participants must abide by an extensive web of statutes and regulations as they perform essential aspects of their business. They thus are particularly in need of notice of what conduct is prohibited by this legal framework so that they may "steer between lawful and unlawful conduct." *Grayned v. City of Rockford*, 408 U.S. 104, 108-109 (1972). That need for guidance remains equally strong regardless of whether the question of interpretation arises in a civil or criminal enforcement proceeding—the statute is the same in both.

The rule of lenity's second goal is to maintain the separation of powers by ensuring that Congress maintains control over the criminal code. The criminal law must evolve through legislation—not by executive proclamation or by common law accretion. *See, e.g.*, *United States v. Santos*, 553 U.S. 507, 514 (2008) (plurality op.) (applying rule of lenity). An agency should not have any arguable authority to widen the scope of a criminal statute to prohibit more conduct than Congress clearly has.[8] The rule of lenity ensures that a defendant may be punished

---

[8] This separation of powers concern is particularly acute in light of the growing administrative state that overlaps with a significant portion of the country's criminal laws. There are an estimated 3,600 to 4,500 federal criminal statutes in the United States. Cottone, *Rethinking Presumed Knowledge of the Law in the Regulatory Age*, 82 Tenn. L. Rev. 137, 141-142 (2014). The administrative state "wields vast power and touches almost every aspect of daily life," *Free*

only when Congress has fairly warned the defendant what conduct qualifies for punishment.

B. The SEC's Newly Minted Interpretation Of § 17(a)(3) Does Not Merit Deference

Since the SEC issued its order against Flannery, it has repeatedly urged courts to defer to its interpretation of § 17(a) under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *See* Letter of Supplemental Authority 1, *SEC v. Big Apple Consulting USA, Inc.*, No. 13-11976 (11th Cir. Dec. 16, 2014); Supplemental Response 4-7, *SEC v. AgFeed Indus., Inc.*, No. 14-cv-663 (M.D. Tenn. Mar. 23, 2015). The Court should reject any call for deference here. The rule of lenity is a basic tool of statutory construction, one that must be used to resolve any statutory ambiguity before *Chevron* could be brought to bear.

Chevron does not command that a court abdicate its duty to declare what the law is in favor of any reasonable agency interpretation of the law. Rather, *Chevron* deference is called for only if a statute remains ambiguous after the court has employed "traditional tools of statutory construction." *Chevron*, 467 U.S. at 843 n.9; *see City of Arlington v. FCC*, 133 S. Ct. 1863, 1868 (2013) (courts should

---

Enterprise Fund v. Public Company Accounting Oversight Bd., 561 U.S. 477, 499 (2010), with "reams of regulations" that would have been unimaginable to the Framers, *Federal Maritime Comm'n v. South Carolina State Ports Authority*, 535 U.S. 743, 755 (2002).

apply "ordinary tools of statutory construction" at *Chevron* step one). The rule of lenity is just such a traditional tool. If it (or other accepted tools) of construction "resolve[] a statutory doubt in one direction, an agency may not reasonably resolve it in the opposite direction." *Carter v. Welles-Bowen Realty, Inc.*, 736 F.3d 722, 731 (6th Cir. 2013) (Sutton, J., concurring).

This conclusion accords with the *Chevron*'s animating logic. *Chevron* deference rests on a presumption that Congress intends for an agency to make reasonable judgments in filling interpretive gaps left in a statute that is committed to the agency's administration. *See Chevron*, 467 U.S. at 843-844. For "humdrum regulatory statutes" that contemplate only civil enforcement, that presumption makes sense. *Carter*, 736 F.3d at 729-730 (Sutton, J., concurring). But there is no reason to presume that Congress intends agencies to "fill gaps" and resolve ambiguities in criminal statutes *against* defendants. *See Whitman v. United States*, 135 S. Ct. 352, 353 (2014) (Scalia, J., respecting the denial of certiorari). As a practical matter, "[t]his theory would allow one administration to criminalize conduct within the scope of the ambiguity, the next administration to decriminalize it, and the third to recriminalize it, all without any direction from Congress." *Carter*, 736 F.3d at 729 (Sutton, J., concurring). As a doctrinal matter, this deference would be completely out of step with the Supreme Court's longstanding refusal to defer to the prosecution's reading of the criminal law. Criminal statutes "are for [the] courts, not for the Government, to construe." *Abramski v. United States*, 134 S. Ct. 2259, 2274 (2014).

The conclusion that, when, as here, an agency's interpretation is offered for the first time in an enforcement proceeding, any consideration of *Chevron* deference can come only after the rule of lenity has been applied also follows from the Supreme Court's reasoning in *Babbitt v. Sweet Home Chapter of Communities for a Great Oregon*, 515 U.S. 687 (1995). In *Babbitt*, the Court addressed a facial challenge to a longstanding regulation embodying an agency's interpretation of a statute in a declaratory judgment action. In those circumstances, the Court asserted in a footnote, the rule of lenity would not trump *Chevron* deference. *Id*. at 704 n.18. The Court explained that the challenged regulation "has existed for two decades and gives a fair warning of its consequences," thus satisfying the rule of lenity's goal of fair notice. *Id*. The result might have been different, the Court implied, if the regulation had just been promulgated. The Court thus also effectively reaffirmed that the rule of lenity *does* apply to cases—like Flannery's—where an agency interprets a statute to a defendant's detriment in "a specific factual dispute … where no regulation [is] present." *Id*.[9]

[9] Two courts of appeals have refused—in footnotes—to apply the rule of lenity to an agency's interpretation of a hybrid statute. The Fourth Circuit stated that the rule of lenity should not apply in a facial challenge to regulations. Its only reasoning was that disagreements over the meaning of these particular regulations

CONCLUSION

The Court should grant the petitions and vacate the Commission's Order and Opinion against Flannery and Hopkins.

---

were "far more likely to arise in [civil] contests … than in a criminal courtroom." *National Rifle Ass'n v. Brady*, 914 F.2d 475, 479 n.3 (4th Cir. 1990). That statement ignores the Supreme Court's repeated holding that the rule of lenity applies in civil cases construing criminal statutes, regardless of whether criminal prosecutions are less likely than civil enforcements. *See, e.g.*, *American Broadcasting*, 347 U.S. at 296. In *United States v. Kanchanalak*, 192 F.3d 1037 (D.C. Cir. 1999), the D.C. Circuit refused to apply the rule of lenity to a statutory prohibition in a criminal proceeding because, as in *Babbitt*, it determined that a longstanding regulation (as well as a previously issued advisory opinion) had satisfied the rule of lenity's fair notice requirements. *Id*. at 1050 & n.17. Even assuming *Kanchanalak* was correctly decided, the D.C. Circuit's approach, like the Supreme Court's in *Babbitt*, indicates that the rule of lenity should be applied when an agency's interpretation is announced for the first time in an enforcement proceeding.

A court may, of course, defer to an agency's interpretation of a hybrid regulation when its interpretation accords with the rule of lenity. *NLRB v. Oklahoma Fixture Co.*, 332 F.3d 1284, 1289 (10th Cir. 2003) (en banc) (deferring to NLRB interpretation of statute, in part, because agency broadly construed an *exemption* to criminal liability); *id.* at 1292 (Briscoe, C.J., and Henry, J., concurring) (explaining that NLRB's interpretation accords with rule of lenity).

Respectfully submitted.

/s/ Jonathan G. Cedarbaum

KATE COMERFORD TODD
U.S. CHAMBER LITIGATION
CENTER, INC.
1615 H Street NW
Washington, DC 20062
(202) 463-5337
ktodd@USChamber.com

JONATHAN G. CEDARBAUM
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue NW
Washington, DC 20006
(202) 663-6000
jonathan.cedarbaum@wilmerhale.com

June 15, 2015

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned hereby certifies that this brief complies with the type-volume limitation of Fed. R. App. P. 29(d).

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B), the brief contains 5,274 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 14 point Times New Roman font. As permitted by Fed. R. App. P. 32(a)(7)(C)(i), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

/s/ Jonathan G. Cedarbaum
JONATHAN G. CEDARBAUM
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue NW
Washington, DC 20006
(202) 663-6000
jonathan.cedarbaum@wilmerhale.com

June 15, 2015

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of June, 2015, I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the First Circuit using the appellate CM/ECF system, and that the following counsel of record will be served by the CM/ECF system:

Mark W. Pearlstein
Laura McLane
Fredric D. Firestone
David H. Chen
(for Petitioner John P. Flannery)

Robert B. Baker
Deena R. Bernstein
Benjamin L. Schiffrin
Kathleen B. Shields
Lisa K. Helvin
(for Respondent U.S. Securities & Exchange Commission)

John F. Slyvia
Andrew N. Nathanson
Jessica C. Sergi
(for Petitioner James D. Hopkins)

/s/ Jonathan G. Cedarbaum
JONATHAN G. CEDARBAUM
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue NW
Washington, DC 20006
(202) 663-6000
jonathan.cedarbaum@wilmerhale.com

June 15, 2015