Supreme Court, U.S.
FILED
JUN 2 - 2009
OFFICE OF THE CLERK

No. 08-1165

IN THE
Supreme Court of the United States

MARK LEVY,
Petitioner,
v.

STERLING HOLDING COMPANY, LLC;
NATIONAL SEMICONDUCTOR CORPORATION; AND
FAIRCHILD SEMICONDUCTOR INTERNATIONAL, INC.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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June 2, 2009

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The Third Circuit below held that an SEC "clarifying" rule could exempt certain transactions from a crucial securities-law provision even though those transactions pre-dated promulgation of the rule by years and a court of appeals had previously determined that those transactions were *not* exempt under the SEC's then-existing rule. That holding created or sharpened three splits among courts of appeals regarding core principles of retroactivity and agency rulemaking. Those conflicts among the courts of appeals on these important and recurring topics alone warrant this Court's attention. Review is particularly appropriate here, however, because the legal framework endorsed by the Third Circuit cannot be reconciled with this Court's elucidation of retroactivity principles in *Bowen* and *Landgraf*. Left standing, the decision below substantially narrows the circumstances in which agency rules are subject to *Bowen*'s ban on retroactive rulemaking. That outcome countermands this Court's strong presumption against retroactivity.

Review of the Third Circuit's statutory holding is also necessary. Congress has delegated to the SEC authority to create only those exemptions from Section 16(b) that accord with the statute's "purpose." But the text, history, and structure of the statute establish that the purpose of Section 16(b) is broadly to prevent profiteering and speculative abuse from insider short-swing transactions. New Rule 16b-3, however, rests on a narrow and flawed understanding of the purpose of the provision. Because the SEC's unlawful interpretation of Section 16(b) has the potential to weaken the stability of financial markets, this Court's review is imperative.

ARGUMENT

I. REVIEW OF THE THIRD CIRCUIT'S RETROACTIVITY HOLDING IS WARRANTED

A. The Circuits Are Divided Over Agency Retroactivity Analysis

1. The Third Circuit concluded that, in assessing the retroactive effect of an agency rule, it is irrelevant whether the rule "conflicts with a judicial interpretation of the pre-amendment law." Pet. App. 28a. The Third Circuit acknowledged that this holding conflicts with decisions of other courts of appeals. *See id.* at 29a (citing Fourth and D.C. Circuit decision as contrary authority). Furthermore, this split in authority is outcome-determinative here: new Rule 16b-3 conflicts with prior Third Circuit law and thus would be deemed impermissibly retroactive (as applied to these claims) in the Fourth, Tenth, and D.C. Circuits. *See* Pet. 14-15. Each of those circuits has held that, if an agency rule conflicts with an earlier court of appeals' decision, applying the new rule to antecedent conduct is impermissibly retroactive. *See National Mining*, 292 F.3d at 860; *Capers*, 61 F.3d at 1110; *Saucedo*, 950 F.2d at 1514-15.

Respondents' attempt to harmonize those decisions with the decision below fails. Respondents argue (at 15), for example, that *National Mining* poses no conflict with the decision below (notwithstanding the Third Circuit's express acknowledgment of a conflict), because the D.C. Circuit held that a new rule must "increase liability" to be retroactive. That is wrong. This Court has never held that an increase in liability is necessary for a law to have an impermissible retroactive effect. The test is whether a "new provision attaches new legal consequences to events completed before its enactment" — a judg-

ment that depends broadly on "the nature and extent of the change in the law." *Landgraf*, 511 U.S. at 270. The snippet of language quoted by respondents cannot plausibly be read to represent the D.C. Circuit's *sub silentio* departure from this Court's guidance; in fact, the D.C. Circuit was careful to emphasize that retroactivity may occur when "a rule changes the law in a way that adversely affects a party's prospects for success on the merits of the claim." 292 F.3d at 860 (internal quotation marks and brackets omitted).

Respondents' distinctions of the Fourth and Tenth Circuit decisions are similarly implausible. Respondents insist (at 15) that *Capers* and *Saucedo* turned on the fact that the new rules at issue there "conflicted with the *plain meaning*" of prior rules, whereas here there was (purportedly) ambiguity in the prior rule. Not so. *Capers* held that "an amendment should be classified as substantive" — and thus having retroactive effect — when it "cannot be reconciled with circuit precedent." 61 F.3d at 1110. The Fourth Circuit did not qualify that holding in any manner, let alone suggest a different principle when a prior rule is unambiguous. The same is true of the Tenth Circuit. *See Saucedo*, 950 F.2d at 1515 ("post hoc clarification" reflected a "substantive change" in the face of a contrary "pre-amendment" interpretation of a provision).

Indeed, in *distinguishing* case law from several circuits that supported the theory that amendments clarifying prior ambiguity do not implicate retroactivity concerns, the Fourth Circuit held that ambiguity in a prior rule might "justify a court's *prospective* application" of a rule but such ambiguity did not "justify *retroactive* application." *Capers*, 61 F.3d at 1111 n.7 (emphases added; collecting contrary authority). *Capers* accordingly leaves no doubt that

the Fourth Circuit would hold that new Rule 16b-3 cannot be applied to antecedent conduct.[1]

2. The Third Circuit's holding that clarifying laws are "necessarily" (Pet. App. 26a) exempt from retroactivity analysis adds to longstanding disagreement among federal courts involving at least nine circuits. In particular, the Third Circuit's holding substantially conflicts with decisions of the D.C. and Federal Circuits. *See* Pet. 16-17.

In response, respondents offer a narrow reading of the Third Circuit's decision. They argue (at 16-17) that the Third Circuit did not hold that "any and all clarifying amendments" are exempt from *Landgraf*'s retroactivity analysis. The sole basis for respondents' contention is a statement by the court in a footnote that, "when ex post facto issues are involved, the rules of the game are different." Pet. App. 29a n.11. Respondents posit (at 17) that "[e]x post facto issues were present" in the cases cited in the petition but absent in this case.

This line of argument begs all of the important questions. The point of *Landgraf* analysis (which the Third Circuit refused to undertake) is to determine when the application of a new law to antecedent conduct has retroactive effect — the civil-law counterpart to ex post facto concerns. *See Landgraf*, 511

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[1] *Bruh v. Bessemer Venture Partners III L.P.*, 464 F.3d 202 (2d Cir. 2006), does not suggest the absence of disagreement among the courts of appeals. There, the Second Circuit found it unnecessary to apply retroactivity analysis with respect to a different SEC rule because under *either* the old rule or the new rule the relevant conduct was exempt. *See id.* at 212-13 & n.11 ("even applying the prior [rule]," the conduct was exempt). That is not the rationale relied upon by the Third Circuit, nor could it have been in light of *Levy I*'s construction of old Rule 16b-3.

U.S. at 270 (test for retroactivity is whether a "new provision attaches new legal consequences" to antecedent events, which includes an increase in liability or an impairment of "vested rights"). That inquiry, as this Court has held, is necessarily factbound and should not turn on labels (e.g., "clarifying") that attach to certain rules. *See St. Cyr*, 533 U.S. at 324; *Martin*, 527 U.S. at 359; *Landgraf*, 511 U.S. at 270; Pet. 22-23. The fundamental error in the Third Circuit's analysis — an error that formed the basis of the split with decisions of the D.C. and Federal Circuits — was the conclusion that a clarifying rule *necessarily* does not have retroactive effect (or implicate ex post facto concerns) and thus need not be subject to the *Landgraf* inquiry. Respondents' reading of the Third Circuit's decision accordingly only underscores the profound mistake in the court's analysis.

In all events, the contention that the Third Circuit did not apply a categorical exemption for clarifying rules is wrong. The Third Circuit was clear that principles governing retroactivity "necessarily" do not apply to mere "clarif[ying]" rules. Pet. App. 26a. The Third Circuit, moreover, *acknowledged* that its legal analysis diverged materially from a decision of the Federal Circuit. *See id.* at 26a-27a. Indeed, respondents continue to press the same broad legal theory in this Court that they advocated below and that they wrongly insist the Third Circuit did not embrace. *See* Opp. 27 (*Bowen* "does not apply to clarifications"); *id.* at 1.[2]

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[2] Respondents' assertion (at 17) that "this case does not implicate ex post facto" or retroactivity concerns is addressed below. *See infra* p. 9. But it suffices to note that, inasmuch as respondents argue that only increases in *liability* trigger retroactivity concerns, respondents are wrong. *See Landgraf*, 511

3. Finally, the Third Circuit created a circuit conflict in holding that the distinction between legislative and interpretive rules "has no bearing on whether a rule has an impermissible retroactive effect." Pet. App. 28a n.10. That unqualified conclusion conflicts with approaches taken by the D.C. and Seventh Circuits, which have recognized the relevance of that distinction in assessing retroactivity. *See* Pet. 18-20.

Respondents respond (at 17-18) that the distinction is a "semantic game[]," incorrectly arguing that the Seventh Circuit's decision in *First National Bank* helps their cause. In that case, the plaintiff-appellant argued that a clarifying amendment "was actually a legislative rule" that could not be applied retroactively under *Bowen.* 172 F.3d at 478. The Seventh Circuit credited that premise, explaining that, "[i]f the Clarifying Amendment is a legislative rule, [the plaintiff-appellant] wins." *Id.* at 478 n.6. That the Seventh Circuit went on to conclude that the rule at issue was *not* legislative and thus could be applied retroactively in no way blunts the obvious conflict between the legal principle applied by the Third Circuit (namely, that the legislative nature of a rule is irrelevant to retroactivity analysis) and the legal principle applied by the Seventh Circuit (namely, that the legislative nature of a rule is relevant to retroactivity analysis).[3]

U.S. at 269-70. The decision below does deprive petitioner of a statutory right to disgorgement. *See* 15 U.S.C. § 78p(b).

[3] Respondents are wrong (at 19) that *Health Insurance Association* is consistent with the decision below. The D.C. Circuit there did analyze the interpretive-legislative nature of the rule but ultimately concluded that, in either event, the agency could not "draw support" for its interpretation from rules adopted

B. The Decision Below Conflicts With Decisions Of This Court

The Third Circuit's decision not only creates or deepens several conflicts among the courts of appeals, but also conflicts with decisions of this Court and bedrock retroactivity law. *See* Pet. 20-24. *Bowen* teaches that, absent an express delegation from Congress, agencies cannot engage in retroactive rulemaking. *Landgraf*, in turn, establishes the framework for determining which rules do and do not have retroactive effect. By failing to undertake the factbound inquiry of whether application of new Rule 16b-3 to the short-swing transactions in this case would have retroactive effect under *Landgraf* and by restrictively defining the instances in which agency rules have retroactive effect, the legal framework adopted by the Third Circuit creates a gaping hole in *Bowen*'s ban on agency retroactivity.

Respondents largely ignore the explanations in the petition for why the Third Circuit's decision countermands this Court's retroactivity jurisprudence. *See* Pet. 20-25. Instead, respondents set forth two arguments (at 25-29) for how the decision below can be reconciled with this Court's precedents. Neither argument withstands scrutiny.

First, respondents devote pages of their opposition to arguing (at 25-27) that "courts cannot turn a blind eye to agency clarifications of ambiguous regulations." That is irrelevant. Petitioner's retroactivity argument has nothing to do with whether a court should enforce *prospectively* an agency rule that clarifies an earlier, ambiguous rule. The question

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after the "transactions" at issue had occurred. 23 F.3d at 425. That principle would have foreclosed the Third Circuit from considering the post hoc SEC rule at issue here.

presented is whether a clarifying rule that conflicts with prior, binding case law or that substantially affects the liabilities or interests of the parties may be applied *retroactively*. *Cf. Capers*, 61 F.3d at 1111 n.7 (ambiguity in prior rule might warrant "prospective" but not "retroactive application" of clarifying rule).

For that reason, respondents' heavy reliance (at 16, 25-26) on *Brand X* is misplaced. *Brand X* held that the FCC was not bound by a prior Ninth Circuit decision construing an ambiguous provision of the Communications Act. *See* Pet. 22 n.3. This Court affirmed the FCC's adoption of a different, prospective interpretation of that same statutory provision. That holding sheds no light on the issue here: whether new Rule 16b-3 is properly applied to conduct *pre-dating* promulgation of the rule in the face of a prior, binding appellate decision interpreting the rule in effect at the time of the transactions.

Second, respondents argue (at 27) that the rule of *Bowen* "does not apply to clarifications." But the cases they cite establish only that certain amended rules — for example, those that replace an otherwise unlawful rule — may be applied in some circumstances to antecedent conduct without raising retroactivity concerns. *See, e.g.*, *Manhattan Gen. Equip. Co. v. Commissioner*, 297 U.S. 129, 135 (1936) (holding, prior to *Bowen* and *Landgraf*, that a new regulation could be applied to prior conduct where "original regulation" was "inconsistent with the statute and unreasonable"). Furthermore, one of respondents' cases acknowledges that there *would* be retroactivity concerns where, as here, an agency has replaced a prior rule with a new rule (there, an agency had not previously issued regulations on the topic). *See Smiley v. Citibank (South Dakota), N.A.*, 517 U.S.

735, 744 n.3 (1996) (when regulation "replace[s] a prior agency interpretation" it may raise retroactivity concerns as applied to "antecedent transactions"). In all events, none of respondents' cases supports the Third Circuit's *per se* rule that clarifying rules are outside the ambit of *Bowen* and *Landgraf*. *See, e.g.*, *Martin*, 527 U.S. at 359 ("label[s]" do not answer the question whether a new law "operates retroactively").

Nor are respondents correct (at 28-29) that there are no retroactivity concerns here even if *Bowen* and *Landgraf* were applied. This is, of course, precisely the inquiry that the court below refused to undertake. But a proper application of *Landgraf* would show that application of new Rule16b-3 is impermissibly retroactive. *See* Pet. 21-24; *supra* note 2. The Third Circuit applied a rule promulgated years after the transactions at issue in the face of a prior judicial decision holding that the transactions were not exempt from Section 16(b). The application of new Rule 16b-3 to antecedent transactions thus implicates paradigmatic retroactivity concerns, including, among other things, upsetting the reliance interests of petitioner on *Levy I*, transforming after the fact the liabilities and duties of respondents during the period of the short-swing transactions, and divesting issuers and shareholders of the statutory rights under Section 16(b) that were in place at the time of the transactions. *See, e.g.*, *Landgraf*, 511 U.S. at 265 (the "legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place") (internal quotation marks omitted).

II. REVIEW OF THE THIRD CIRCUIT'S STATUTORY HOLDING IS WARRANTED

A. Section 16(b) prohibits insider profiteering on short-swing trading — transactions found by Congress to be rife with speculative abuse — for the dual purpose of preventing speculation *and* curbing insiders' ability to exploit non-public information. *See* Pet. 26-31. By focusing only on the latter purpose and adopting an exemptive rule that took no account of the former, and by ignoring the former in promulgating an exemption that provides insiders with the ability to exploit non-public information to profit from short-swing trading, the SEC materially weakened the disgorgement remedy in Section 16(b), contrary to the statute's "purpose."

Respondents selectively cite passages from this Court's cases to suggest that Section 16(b) pertains only to trading on non-public information. They ignore that provision's other overarching purpose: to curb speculative abuse. *Foremost-McKesson*, on which respondents heavily rely, acknowledged that the framers of Section 16(b) intended to combat *both* short-term speculation as well as trading on inside information. *See* 423 U.S. at 246. Respondents also quote extensively from *Reliance Electric*, which expressly recognizes that Section 16(b)'s broad prophylactic rule was designed "to eradicate speculative abuses." 404 U.S. at 422 (internal quotation marks omitted).

The text, history, and structure of Section 16(b) establish that Congress gave the SEC narrowly circumscribed authority to craft exceptions to Section 16(b). *See* Pet. 28-30. Respondents maintain (at 24 n.18) that petitioner "would read out of Section 16(b)" the SEC's authority "to promulgate . . . exemptive

rules," but that is not so. The SEC has the power to exempt transactions that are "not comprehended within the purpose" of the statute, 15 U.S.C. § 78p(b) — trades that neither present the risk of speculative abuse nor seek to capitalize on non-public information. But, in enacting new Rule 16b-3, the SEC explicitly ignored concerns about speculative abuse and stated erroneously that Section 16(b) was concerned *only* with information asymmetries. *See* 70 Fed. Reg. 46,080, 46,083 (Aug. 9, 2005). Furthermore, under respondents' view of the statute, an insider can buy shares from the issuer using insider information and then profit from an informational asymmetry by selling those shares into the market. Incidents of insider profits resulting from these exact types of short-swing trades prompted investigation by Congress and led to enactment of Section 16(b).

In sanctioning such a result, the SEC disregarded Congress's intent to curb speculation broadly — an intent evident from the statute's text, history, and structure (*see* Pet. 31 & n.5) — as well as the intent to curb an insider's ability to exploit inside information at the expense of market participants. Accordingly, new Rule 16b-3 cannot survive review under *Chevron*. Where, as here, "the intent of Congress is clear, that is the end of the matter." 467 U.S. at 842.

B. The securities laws are among the most important safeguards of properly functioning markets. Whether Section 16(b) is narrowly or broadly interpreted profoundly affects Congress's goal of stabilizing markets and ensuring investor confidence. The *amicus* brief of the National Conference on Public Employee Retirement Systems underscores the importance of Section 16(b), which can affect the retirement savings of millions of Americans. Especially

now that market stability is of paramount concern, a proper interpretation of Section 16(b) by this Court should not wait.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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