Supreme Court, U.S.
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No. __-____

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**

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the rule against retroactive agency rulemaking of *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), and the principles of retroactivity analysis of *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), are categorically inapplicable to amended agency rules that purport to clarify agency rules but that conflict with courts of appeals' prior interpretations of those rules.

2. Whether the Securities and Exchange Commission's new Rule 16b-3, 17 C.F.R. § 240.16b-3 (2005) — which exempts from disgorgement those short-swing profits realized from an insider's acquisition of securities from the insider's own company — is a lawful interpretation of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), which provides for a broad, prophylactic right to recover profits acquired by an insider as a result of short-swing transactions in the insider's own company's securities.

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Mark Levy respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

INTRODUCTION

This case presents an acknowledged conflict among the circuits regarding the proper application of this Court's decisions in *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), and *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), with respect to agency rules. This Court held in *Bowen* that agencies, such as the Securities and Exchange Commission ("SEC"), presumptively lack the authority to adopt retroactive rules. In *Landgraf*, this Court explained how to identify those statutes and rules that have retroactive effect. Notwithstanding this Court's guidance, at least three pervasive and deep splits exist among the courts of appeals regarding the circumstances in which agency rules fit within the ambit of *Bowen* and *Landgraf*. This case implicates all three conflicts, each of which could be outcome-determinative in petitioner's favor.

First, the Third Circuit held that, in determining whether an agency's purported clarification of a rule has a retroactive effect, it is of no moment whether the amending rule is substantially inconsistent with a prior interpretation of the existing rule by a court of appeals. That decision creates an acknowledged conflict among the Fourth, Tenth, and D.C. Circuits on one side, and the Third and Seventh Circuits on the other. That difference in legal standard, moreover, is outcome-determinative because the SEC's "clarifying" rule conflicts with a prior Third Circuit decision. Second, the Third Circuit concluded that so-called clarifying agency rules are excluded auto-

matically and categorically from the prohibition of *Bowen* and the principles of *Landgraf*. That holding adds to a mature circuit split that now involves nine courts of appeals. Third, the Third Circuit held that a rule's status as legislative or interpretive has no bearing on retroactivity analysis. That squarely conflicts with decisions of the D.C. and Seventh Circuits; the conflict is likely outcome-determinative in this case because the SEC's new Rule 16b-3, 17 C.F.R. § 240.16b-3 (2005), is legislative in nature. This Court should grant the petition and resolve those conflicts.

Certiorari is also warranted on the second question presented. The Third Circuit below held that Congress has delegated to the SEC near plenary authority to create exemptions to Section 16(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78p(b). In fact, Congress provided the SEC with limited authority to create exemptions for transactions not contemplated by the "purpose" of Section 16(b), which implements the Exchange Act's objective of containing manipulation and unreasonable fluctuations in share prices that had contributed to the Great Depression. Traditional tools of statutory construction compel the conclusion that Section 16(b)'s "purpose" is broadly to prevent insiders from profiting from short-swing transactions regardless of whether those transactions were founded on insider information or informational asymmetries. The Third Circuit therefore erred in granting deference to the SEC's blinkered interpretation of Section 16(b)'s "purpose."

Because Section 16(b) is critical to fulfilling the Exchange Act's objectives, the petition should be granted.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-31a) is reported at 544 F.3d 493. The opinion of the district court (Pet. App. 32a-62a) is reported at 475 F. Supp. 2d 463. A prior opinion of the court of appeals (Pet. App. 63a-99a) is reported at 314 F.3d 106.

JURISDICTION

The court of appeals entered its judgment on October 1, 2008, and denied a petition for rehearing on November 18, 2008 (Pet. App. 100a). On February 10, 2009, Justice Souter extended the time within which to file a petition for a writ of certiorari to and including March 18, 2009. *Id.* at 114a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), and the 1996 and 2005 versions of SEC Rules 16b-3 and 16b-7, 17 C.F.R. §§ 240.16b-3 and 240.16b-7, are reproduced at Pet. App. 102a-113a.

STATEMENT

A. Legal Background

This case involves the provision of the Securities Exchange Act of 1934 ("Exchange Act") that provides for disgorgement of profits when insiders engage in short-swing trading. *See* 15 U.S.C. § 78p(b). Disgorgement is designed to remove any incentive that insiders may have to engage in speculative abuse through such trades. Specifically, Section 16 allows corporations and their shareholders the right to recover any profits from officers, directors, and beneficial owners (that is, owners of more than 10% of

any given class of stock) who bought and sold (or sold and bought) a security within six months. *See id.* § 78p(a), (b).

At the heart of this litigation is an exchange of Fairchild Semiconductor International, Inc. ("Fairchild") preferred stock, owned by National Semiconductor Corporation ("National") and Sterling Holding Company, LLC ("Sterling"), for Fairchild Class A common stock. National and Sterling claim that SEC rules have exempted from recovery the profits realized from National's and Sterling's acquisition of Class A common stock through the exchange, and National's and Sterling's subsequent short-swing sales of Class A common stock.

Section 16(b) calls for the disgorgement of profits by insiders who have engaged in short-swing trading. Liability under the section has four elements: (1) the purchase (or sale) of a security; (2) the sale (or purchase) of a security; (3) within a period of six months; (4) by an officer, director, or beneficial owner of more than 10% of any class of the issuer's securities. *See id.* § 78p(b).

At issue here is whether National's and Sterling's exchange of Fairchild preferred stock for Class A common stock in August 1999 qualifies as a purchase under Section 16(b). If it does, National and Sterling are subject to disgorgement pursuant to Section 16(b) because the other three elements are indisputably satisfied here: National and Sterling sold the securities in January 2000; the sale was within six months of the exchange; and National and Sterling were statutory insiders, as they both appointed senior executive officers to Fairchild's board of directors and were also beneficial owners of more than 10% of both classes of common stock. *See* Pet. App. 4a.

Section 16(b) exempts those short-swing transactions that "the [SEC] by rules and regulations may exempt as not comprehended within the purpose of this subsection." 15 U.S.C. § 78p(b). The statute itself partially elucidates the purpose, which the SEC is tasked with implementing: "preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer." *Id.* Although the statute makes reference to insider trading, scholars have noted that other statutes also address insider trading, often more directly and concretely than does Section 16(b). *See* Steve Thel, *The Genius of Section 16: Regulating the Management of Publicly Held Companies*, 42 Hastings L.J. 391, 394-95 (1991). Thus, beyond a general concern with insider trading, Section 16(b)'s purpose is a concern with short-swing trading as an evil in itself, regardless of whether such trading is the product of insider information. The statute's drafters sought to prevent *speculation*, not just trading on inside information, by officers, directors, and substantial beneficial owners of company stock. *See* S. Rep. No. 73-1455, at 186-87 (1934).

The SEC has promulgated exemptive rules to Section 16(b), one of which is relevant here. Rule 16b-3(d) exempts certain grants and awards from Section 16(b)'s ambit. The version of Rule 16b-3(d) in effect from 1996 to 2005 — the time period pertinent to this case — provided, in relevant part:

> Any transaction involving a grant, award or other acquisition from the issuer (other than a Discretionary Transaction) shall be exempt if:
>
> (1) The transaction is approved by the board of directors of the issuer, or a committee of the

board of directors that is composed solely of two or more Non-Employee Directors;

(2) The transaction is approved or ratified, in compliance with section 14 of the Act, by either: the affirmative votes of the holders of a majority of the securities of the issuer present, or represented, and entitled to vote at a meeting duly held in accordance with the applicable laws of the state or other jurisdiction in which the issuer is incorporated . . . ; or

(3) The issuer of equity securities so acquired are held by the officer or director for a period of six months following the date of such acquisition, *provided that* this condition shall be satisfied with respect to a derivative security if at least six months elapse from the date of acquisition of the derivative security to the date of disposition of the derivative security (other than upon exercise or conversion) or its underlying equity security.

17 C.F.R. § 240.16b-3(d) (1996).

When it promulgated Rule 16b-3, the SEC stated the rule's purpose as exempting transactions associated with employee benefit plans from Section 16(b). *See* Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release Nos. 34-37260, 35-26524, 61 Fed. Reg. 30,376, 30,378-79 (June 14, 1996). In *Levy v. Sterling Holding Co.*, 314 F.3d 106 (3d Cir. 2002) ("*Levy I*"), the precursor appeal in this case, the Third Circuit held that transactions must have a "compensatory nexus" to qualify for the exemption embodied in Rule 16b-3. Pet. App. 97a-98a.

Responding to *Levy I*, the SEC in 2005 promulgated a new rule expanding the scope of the exemption. New Rule 16b-3 provides:

> Any transaction, other than a Discretionary Transaction, involving an acquisition from the issuer *(including without limitation a grant or award), whether or not intended for a compensatory or other particular purpose*, shall be exempt if [one of the same three conditions is met].

17 C.F.R. § 240.16b-3(d) (2005) (relevant changes italicized).[1]

B. Facts and Proceedings Below

1. In 1997, Fairchild was created as a spinoff of National, a Delaware corporation, pursuant to an Agreement and Plan of Recapitalization. Under the agreement, National and Sterling were permitted to appoint three of the seven members of Fairchild's board of directors. The agreement also provided that National and Sterling would receive a mix of the three classes of Fairchild stock that were created: (1) Class A common stock, which included voting rights; (2) Class B common stock, which did not include voting rights; and (3) preferred stock, which provided for a cumulative dividend. Both National and Sterling are undisputedly insiders covered by Section 16(b): National owned 14.8% of the Class A common stock, Sterling held 48% of the Class A common stock, and they each appointed their senior executive officers as members of Fairchild's board of directors (National appointed its CEO; Sterling appointed two of its senior executive officers). By virtue of that insider status, National and Sterling were at all relevant times subject to Section 16(b).

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[1] Although National and Sterling argued that both new Rules 16b-3 and 16b-7 exempted their exchange of preferred stock for Class A common stock from the ambit of Section 16(b), the Third Circuit in *Levy II* resolved the case based on the application of new Rule 16b-3 alone.

In 1999, upon the unanimous consent of its board of directors, Fairchild prepared to undertake an initial public offering ("IPO"). As part of a recapitalization effort that preceded the IPO, Fairchild's board of directors, on the advice of the underwriter, an affiliate of Sterling, voted unanimously to recommend that all preferred stock be converted into Class A common stock. On July 1, 1999, with National and Sterling together controlling 62.8% of the Class A common stock, a majority of the Class A common stockholders voted to approve the exchange of Fairchild preferred stock for Fairchild Class A common stock. The exchange required an amendment of Fairchild's Certificate of Incorporation, which in turn required Sterling's consent. Both National and Sterling consented to the amendment. The IPO was completed on August 9, 1999. In accordance with the proposed conversion formula, National's preferred stock was converted into 888,362 shares of Class A common stock and Sterling's preferred stock was converted into 4,021,428 shares of Class A common stock.

On January 19, 2000, barely five months after the IPO and the exchange of the preferred stock for Class A common stock had taken place, National sold 7,234,360 shares of its Class A common stock and Sterling sold 11,115,000 shares of its Class A common stock in Fairchild's secondary offering. As a consequence of these transactions, National and Sterling realized short-swing profits of $12,850,679.60 and $58,501,592.90, respectively.

In November 2000, petitioner, a shareholder in Fairchild, brought a suit on behalf of Fairchild against National and Sterling for the disgorgement of National's and Sterling's short-swing profits. In

the district court, National and Sterling argued that the then-applicable exemptions embodied in Rules 16b-3 and 16b-7 precluded liability and that the action should be dismissed. Based upon those exemptions, the court dismissed the action.

2. In *Levy I*, the Third Circuit reversed. The Third Circuit reviewed the release that accompanied the 1996 version of the rule and concluded that "Rule 16b-3 primarily is concerned with employee benefit plans." Pet. App. 94a. The court interpreted the "other acquisition" prong of the exemption to apply only to plans that provided for "participant-directed transactions," such as deferrals of bonuses into phantom stock and other deferred compensation programs, and held that the weight of the SEC's pronouncements on Rule 16b-3(d) suggested that a transaction would qualify for the exemption only if it has "some connection to a compensation-related function." *Id.* at 96a-97a, 98a. Although the Third Circuit acknowledged language in the SEC's release indicating that the transaction need not have a compensatory element, the court found that that language did not undercut its ultimate conclusion. Instead, such language simply indicated that "the form of a transaction is not what matters." *Id.* at 98a.

The Third Circuit emphasized that its reading was the soundest interpretation of Section 16(b)'s language and the most logical in advancing its purposes:

> The result we reach is sensible. We think that adopting National's and Sterling's view would result in any transaction between the issuer company and an officer or director that meets the remaining requirements of Rule 16b-3(d) — approval of the transaction by the board of directors or a majority of shareholders, or holding of the

> securities by the officer or director for more than six months — being immunized from section 16(b) liability. The potential for self-dealing could be great: in a closely held corporation, directors or a majority of shareholders could arrange for the acquisition of stock in advance of an IPO, and turn around and sell shares shortly after the IPO. Because of their insider status, there would be a concern about speculative abuse injurious to other market participants.

Id. at 98a (footnote omitted).[2] *Levy I* thus remanded the case to the district court for further proceedings.

3. After *Levy I*, the SEC in 2005 initiated a rulemaking for the express purpose of reversing the Third Circuit's holdings in this case with respect to the scope of Rules 16b-3 and 16b-7. The SEC indicated that, in expressing its disagreement with the Third Circuit, it was merely "clarifying" the scope of the exemptions. Pet. App. 12a (internal quotation marks omitted).

Following promulgation of the new exemptive rules, the district court ruled on the prior-filed cross-motions for summary judgment. The district court determined that the new rules promulgated in 2005 should apply to the conduct at issue — from 1999 and 2000 — and granted summary judgment to National and Sterling. *See id.* at 14a-15a.

4. This time on appeal, the Third Circuit affirmed the district court. In so doing, it rejected Levy's arguments that new Rule 16b-3 should not apply to

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[2] *Levy I* also rejected claims that Rule 16b-7 exempted the exchange of preferred stock for Class A common stock from Section 16(b). *See* Pet. App. 77a-84a. As noted above, though, the court in *Levy II* did not reach the issue of the applicability of new Rule 16b-7 to the present case.

conduct that predated the rule's promulgation. The court also disagreed with Levy's submission that the new rules exceed the scope of the SEC's rulemaking authority under Section 16(b).

The court below held that applying new Rule 16b-3 to conduct that predated its adoption did not present a retroactivity problem. The court reasoned that a rule that merely clarifies an earlier regulation may apply to prior conduct without being impermissibly retroactive. The Third Circuit articulated four factors that determine whether a rule is simply a clarification that can apply to earlier conduct: "(1) whether the text of the old regulation was ambiguous; (2) whether the new regulation resolved, or at least attempted to resolve, that ambiguity; (3) whether the new regulation's resolution of the ambiguity is consistent with the text of the old regulation; and (4) whether the new regulation's resolution of the ambiguity is consistent with the agency's prior treatment of the issue." Pet. App. 27a (citations omitted). In crafting that test, the court acknowledged the omission of one element that other circuits have found dispositive as to retroactivity analysis: whether the new rule conflicts with a judicial interpretation of the old rule. Thus, the Third Circuit expressly parted ways with the Fourth and D.C. Circuits on this issue. *See id.* at 28a.

The Third Circuit also rejected Levy's claim that the SEC's new rules are improper exercises of its authority under Section 16(b). The court held that the new rules pass muster under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). In effect, the court held that Congress had given the SEC virtually plenary power to decide

which transactions should be exempt from the ambit of Section 16(b) liability. *See* Pet. App. 20a-21a.

REASONS FOR GRANTING THE PETITION

I. THE THIRD CIRCUIT'S TEST FOR DETERMINING WHEN AGENCY CLARIFYING RULES HAVE RETROACTIVE EFFECT DEEPENS ACKNOWLEDGED CONFLICTS AMONG THE CIRCUITS AND DEPARTS FROM THIS COURT'S DECISIONS

This Court's precedents establish two concordant principles relating to retroactive agency decision-making. First, "[r]etroactivity is generally disfavored in the law in accordance with fundamental notions of justice that have been recognized throughout history." *Eastern Enters. v. Apfel*, 524 U.S. 498, 532 (1998) (plurality) (citation omitted; internal quotation marks omitted). A strong presumption against "retroactiv[ity]" exists that "is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994). Given the disfavored nature of retroactivity, federal courts are obligated to analyze carefully whether application of a law or regulation would have a retroactive effect. *See id.* at 269-70.

Second, because "retroactivity is not favored in the law," and because "an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress," agencies lack the authority to promulgate rules with retroactive effect unless their organic statute "requires this result." *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988); *see also id.* at 223-24 (Scalia, J., concurring) ("[r]etroactive legislation has always been looked upon with disfavor," and it is therefore "unsurprising"

that Congress "has been unwilling to confer" retroactive rulemaking authority on agencies). The SEC has no such authority.

This case presents several acknowledged conflicts regarding application of these retroactivity principles. In determining whether the SEC's new Rule 16b-3 could be applied to pending claims and, in fact, to conduct predating promulgation of the rule, the Third Circuit created a sharp split with other courts of appeals' decisions on multiple issues concerning agency retroactivity. This Court's review is needed to resolve these conflicts and to secure uniformity on the proper standards for assessing the retroactivity of agency rules. Certiorari is independently warranted because the decision below conflicts with the force of *Bowen* and *Landgraf* by allowing agencies to engage in retroactive rulemaking and to insinuate new rules into pending lawsuits.

A. The Courts Of Appeals Are Divided With Respect To The Proper Legal Standard For Determining When Agency Rules Are Impermissibly Retroactive

The Third Circuit's test for identifying retroactive agency rules — which it applied in determining that the SEC's new Rule 16b-3 does not implicate *Bowen* or *Landgraf* — conflicts with other courts of appeals' judgments in three important respects.

1. The Third Circuit's decision deepens a sharp split among courts of appeals on whether agency rules inconsistent with previous courts of appeals' decisions are necessarily retroactive as applied to pending claims

The Third Circuit held that it is irrelevant whether "Congress has delegated retroactive rulemaking power to [an] agency" where a new rule that is applied to

conduct predating its promulgation "constitutes a clarification . . . of the law as it existed beforehand." Pet. App. 26a. In applying that standard, the Third Circuit deemed it immaterial whether an agency amendment "conflicts with a judicial interpretation of the pre-amendment law." *Id.* at 28a.

The Seventh Circuit follows a legal approach substantially similar to the Third Circuit's. In *United States v. Fones*, 51 F.3d 663 (7th Cir. 1995), the Seventh Circuit held that, although a new comment to the Sentencing Guidelines "effectively nullifie[d] the law of the Seventh Circuit," the comment must be treated "as a clarifying rather than substantive change." *Id.* at 669. The court of appeals thus held that the new interpretation could be applied to prior conduct. *See id.*

The Third and Seventh Circuits' approach conflicts with other courts of appeals' decisions, as the court below acknowledged. *See* Pet. App. 28a-29a (citing Fourth and D.C. Circuit precedent as contrary authority). The D.C. Circuit, for example, has held that, if an agency rule conflicts with an earlier court of appeals' decision, applying that rule to prior conduct would have a retroactive effect. In *National Mining Association v. Department of Labor*, 292 F.3d 849 (D.C. Cir. 2002), the D.C. Circuit applied *Bowen* and *Landgraf* to rules promulgated under the Black Lung Benefits Act. The government had posited that all of the rules were procedural and thus could be applied to prior conduct. The D.C. Circuit noted that an agency rule that "changes the legal landscape" of norms affecting primary conduct, if applied to prior conduct, would be impermissibly retroactive. *Id.* at 859 (internal quotation marks omitted). In determin-

ing whether a rule would change the legal landscape, the court applied the following legal standard:

> If a new regulation is substantively inconsistent with a prior regulation, prior agency practice, or *any Court of Appeals decision rejecting a prior regulation or agency practice*, it is retroactive as applied to pending claims.

Id. at 860 (emphasis added); *accord Marrie v. SEC*, 374 F.3d 1196, 1208 (D.C. Cir. 2004).

The Fourth and Tenth Circuits' approach accords with the D.C. Circuit's. In *United States v. Capers*, 61 F.3d 1100 (4th Cir. 1995), the Fourth Circuit held that "an amendment should be classified as substantive, not clarifying, when it cannot be reconciled with circuit precedent." *Id.* at 1110. Similarly, the Tenth Circuit, in *United States v. Saucedo*, 950 F.2d 1508 (10th Cir. 1991), held that, when an amendment requires a court to overrule precedent, such an amendment cannot be a mere clarification; rather, the change is a substantive one. *See id.* at 1514-15. In each case, the Fourth and Tenth Circuits aligned themselves with the *National Mining Association* principle that a rule contradicting a prior court of appeals' decision is impermissibly retroactive if applied to prior conduct.

This conflict among the courts of appeals is both acknowledged, *see* Pet. App. 28a-29a, and outcome-determinative. New Rule 16b-3 unquestionably is substantively inconsistent with the Third Circuit's decision in *Levy I* — it was promulgated for that purpose. If this case had been brought in the D.C., Fourth, or Tenth Circuit, that fact alone would have compelled the conclusion that new Rule 16b-3 is substantive and may not be applied to pending claims or to conduct predating the rule's promulgation. In

those three circuits, the SEC could not have dictated the outcome of pending litigation involving underlying conduct predating the rule by several years, as it attempts to do here.

2. *The Third Circuit's conclusion that "clarifying" rules are not subject to analysis under* Landgraf *deepens confusion in and adds to disagreement among the circuits*

The Third Circuit's holding that an agency rule that "constitutes a clarification . . . of the law as it existed beforehand" (Pet. App. 26a) is not retroactive was unqualified: the court stated that, "where a new rule constitutes a clarification . . . , the application of that new rule to pre-promulgation conduct *necessarily* does *not* have an impermissible retroactive effect." *Id.* (first emphasis added). The court's conclusion that clarifying rules are categorically exempt from the *Landgraf* retroactivity analysis conflicts with the decisions of two circuits.

First, the decision below acknowledged that the standard it applied conflicts with the Federal Circuit's decision in *Princess Cruises, Inc. v. United States*, 397 F.3d 1358 (Fed. Cir. 2005). *See* Pet. App. 26a-27a (citing *Princess Cruises* as contrary authority). In that case, the Federal Circuit firmly rejected the principle applied by the Third Circuit here that clarifications can necessarily be given retroactive effect, explaining that "the binary analysis — change or clarification — [is] largely unhelpful." 397 F.3d at 1363. The Federal Circuit held that such analysis did not absolve courts of their "obligation to weigh the various factors described in *Landgraf*." *Id.*

Second, in *National Mining Association*, the D.C. Circuit held that labeling a rule as "procedural" or "substantive" is not dispositive of the retroactivity

question. Relying on *Landgraf*, the D.C. Circuit held that a retroactivity analysis requires "commonsense, functional judgment." 292 F.3d at 859-60 (internal quotation marks omitted). The D.C. Circuit also made clear that, regardless of the label that attaches to a rule, courts must undertake the *Landgraf* analysis and assess whether the rule, in actuality, substantively changes the legal landscape and thus has retroactive effect. *See id.* at 859.

The D.C. and Federal Circuits' approach conflicts with that of at least six circuits, which hold that there *is* an automatic and categorical exemption of clarifying laws from the *Landgraf* retroactivity analysis. The Fifth Circuit has held that, upon a determination that a new rule is a mere clarification, it "need not determine whether, under the rule set forth in *Landgraf* . . . , the [agency] intended the rule to have retroactive effect." *Vo v. Gonzales*, 482 F.3d 363, 370 (5th Cir. 2007). The Fourth Circuit similarly holds that a statutory amendment that "merely clarified the meaning" of a statute did not constitute a "retroactive[ ]" application and therefore is not subject to analysis under *Landgraf*. *Brown v. Thompson*, 374 F.3d 253, 258-61 & n.6 (4th Cir. 2004). The First Circuit has concluded that an "amendment" that "was not a change at all, but a clarification that did not alter the law," is not subject to retroactivity analysis. *Liquilux Gas Corp. v. Martin Gas Sales*, 979 F.2d 887, 890 (1st Cir. 1992).

The Eleventh Circuit likewise has held that, once a court determines a rule is a clarification — even when that determination rests on little more than an agency's assurance that the rule is such — no retroactivity concerns are implicated. *See Heimmermann v. First Union Mortgage Corp.*, 305 F.3d 1257, 1260

(11th Cir. 2002); *Piamba Cortes v. American Airlines, Inc.*, 177 F.3d 1272, 1283 (11th Cir. 1999). The Ninth Circuit had adopted a similar categorical rule with respect to legislation, *see ABKCO Music, Inc. v. LaVere*, 217 F.3d 684, 689 (9th Cir. 2000) ("clarifying legislation is not subject to any presumption against retroactivity and is applied to all cases pending as of the date of its enactment"), and the Sixth Circuit has suggested it would do the same, *see Orr v. Hawk*, 156 F.3d 651, 654 (6th Cir. 1998) ("So long as a change in a regulation does not announce a new rule, but rather merely clarifies or codifies an existing policy, that regulation can apply retroactively.").

In sum, disagreement over whether a clarifying law is categorically exempt from retroactivity analysis involves nine circuits and is longstanding. No purpose is served by greater percolation, and this case presents an ideal vehicle for this Court's resolution.

3. *The Third Circuit's holding that the status of the SEC's rule as legislative is irrelevant to retroactivity analysis divides the circuits*

The Third Circuit below rejected petitioner's argument that the SEC's new Rule 16b-3 is a legislative rule and therefore that its retroactive application would impermissibly alter the substantive rights and liabilities of the parties. The court reasoned that the "legislative-interpretive dichotomy has *no bearing* on whether a rule has an impermissible retroactive effect." Pet. App. 28a n.10 (emphasis added). The court explained that the only "significance" of a legislative classification of a rule is that an agency must promulgate it through "notice-and-comment rulemaking procedures." *Id.*

The Third Circuit's unqualified holding that the difference between legislative and interpretive rules "has no bearing" on retroactivity analysis conflicts with decisions of the Seventh and D.C. Circuits. In *Health Insurance Association of America, Inc. v. Shalala*, 23 F.3d 412 (D.C. Cir. 1994), for example, the D.C. Circuit cited *Bowen* for the proposition that "agencies lack the power to promulgate retroactive legislative rules 'unless that power is conveyed by Congress in express terms.'" *Id.* at 422 (quoting *Bowen*, 488 U.S. at 208). Contrary to the Third Circuit's approach, the D.C. Circuit explicitly applied the rubric of *American Mining Congress v. Mine Safety & Health Administration*, 995 F.2d 1106, 1109-10 (D.C. Cir. 1993), to determine whether the underlying rule was in fact legislative or interpretive. *See* 23 F.3d at 422-23.

The Seventh Circuit has sided with the D.C. Circuit on this issue. In *First National Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472 (7th Cir. 1999), the Seventh Circuit reasoned that the framework for assessing whether a rule is legislative or interpretive is coterminous with the issue of whether an agency rule may apply to prior conduct. The Seventh Circuit thus has explained that, "[i]f the Clarifying Amendment is a legislative rule, [the appellant] wins. Under *Bowen*, an administrative rule only has retroactive effect if Congress expressly authorizes the agency to issue retroactive rules." *Id.* at 478 n.6.

This difference in legal standard, moreover, is not academic; it is likely outcome-determinative here. The test for determining the legislative or interpretive nature of a rule in *Health Insurance Association* and *American Mining Congress* compels the conclusion that new Rule 16b-3 is legislative. First, absent

the new rule, "the legislative basis" for application of the SEC's exemptive rule "would be inadequate." *American Mining Congress*, 995 F.2d at 1109. *Levy I* was a binding interpretation of Rule 16b-3; the SEC's new rule is necessary to expand the scope of the exemption. Second, "an agency seems likely to have intended a rule to be legislative if it has the rule published in the Code of Federal Regulations," *id.*, and here new Rule 16b-3 was so published, *see* 17 C.F.R. § 240.16b-3 (2005). Third, "the [SEC] has explicitly invoked" its rulemaking authority under Section 16(b), 995 F.2d at 1112, in promulgating new Rule 16b-3, *see* Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release Nos. 33-8600, 34-52202, 35-28013, 70 Fed. Reg. 46,080, 46,088 (Aug. 9, 2005). Finally, new Rule 16b-3 explicitly amended an earlier legislative rule. *See* 995 F.2d at 1112.

B. The Decision Below Conflicts With This Court's Retroactivity Jurisprudence

The substantial and acknowledged conflicts among the courts of appeals discussed above are more than sufficient to warrant this Court's review. Plenary review in this case is particularly appropriate, however, because the Third Circuit's decision affirming the SEC's obvious efforts to dictate the outcome of pending litigation and to alter the legal consequences of past conduct is deeply flawed: it conflicts with this Court's decisions and undermines the purposes animating *Bowen* and *Landgraf*.

In holding that new Rule 16b-3 could apply retroactively — both in exempting respondents' past short-swing trading from liability and in unsettling petitioner's expectations based on the Third Circuit's

holding in *Levy I* — the court of appeals erred in at least three respects.

First, the Third Circuit erred in holding that the contradiction between a rule and an earlier court of appeals' decision does not implicate problems of retroactivity. *See* Pet. App. 18a-19a. *Landgraf* held that "settled expectations should not be lightly disrupted," 511 U.S. at 265, and that the heart of the anti-retroactivity norm is that a new rule must not "attach[] new legal consequences to events completed before its enactment," *id.* at 270. A conflict between a court of appeals' decision and a clarifying agency rule implicates all of those concerns.

This case is directly on point. In *Levy I*, there was "no dispute" with respect to three of the four elements of liability under Section 16(b) — namely, that respondents were insiders that engaged in "sales" within six months of alleged "purchases." Pet. App. 70a. The issue, the Third Circuit said, was whether the purchases were exempt under the SEC's rules. *See id.* The court held that Rule 16b-3 required "some compensatory nexus" for the exemption to apply and that, because the short-swing transactions of respondents (which occurred in 2000) did not have a compensatory nexus, "the rule is inapplicable here." *Id.* at 97a-98a.

Levy I accordingly not only created expectations, but also adjudicated rules of liability under Section 16(b). Although this Court cautioned in *Landgraf* that a retroactivity problem does not necessarily arise because a new rule "upsets expectations based in prior law," 511 U.S. at 269, it emphasized that the dispositive issue is whether a new rule attaches or alters substantive *legal consequences* of earlier conduct, *id.* at 270. Here, the Third Circuit in *Levy I*

held that respondents' short-swing transactions in 2000 were subject to Section 16(b) and did not qualify for an exemption. That holding fixed the parties' rights and liabilities under the law with respect to the relevant short-swing transactions. Applying new Rule 16b-3 accordingly did more than unsettle the parties' expectations; it altered legal liabilities that a court of appeals had adjudicated. *Accord Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 948 (1997) (amendment that "eliminate[d]" an affirmative "defense" to suit has retroactive effect when applied to prior conduct).[3]

Second, the holding that clarifying rules are categorically exempt from the *Bowen* rule is deeply flawed. Although "it may be possible to generalize about types of rules that ordinarily will not raise retroactivity concerns," this Court has made clear that "these generalizations do not end the inquiry." *Martin v. Hadix*, 527 U.S. 343, 359 (1999). A judgment whether a rule is legislative/interpretive, procedural/substantive, or clarifying/amending is accordingly the beginning, not the end, of retroactivity analysis. *See id.* ("When determining whether a new statute operates retroactively, it is not enough to attach a label (e.g., 'procedural,' 'collateral') to the

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[3] *National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005), does not affect this analysis. The Court held there that "[a] court's prior judicial construction of a statute" does not bind a subsequent agency interpretation. *Id.* at 982. The case did not involve agency rulemaking (the question arose from an agency adjudication), and there was no issue of retroactive application presented. The Court accordingly said nothing about the issue here — namely, under what circumstances a subsequent agency rule that conflicts with a prior court of appeals' decision can be applied to conduct predating promulgation of the rule.

statute; we must ask whether the statute operates retroactively."); *see also Landgraf*, 511 U.S. at 269-70. The Third Circuit's conclusion that clarifying rules can never have a retroactive effect — and therefore that *Landgraf* analysis need not be undertaken — countermands this Court's teaching that "categorical arguments are not particularly helpful in undertaking *Landgraf*'s commonsense, functional retroactivity analysis." *INS v. St. Cyr*, 533 U.S. 289, 324 (2001).

The Third Circuit's application of an erroneous legal standard, predictably, led to an erroneous result. In this case, the purportedly clarifying Rule 16b-3 transformed the nature of respondents' liability under Section 16(b), an issue effectively decided in *Levy I.* Therefore, regardless of whether new Rule 16b-3 can be deemed a clarification of prior law, the rule affected primary conduct and the legal consequences that attach to such conduct. In failing to acknowledge the continuing relevance of the *Landgraf* framework, the decision below conflicts with this Court's retroactivity jurisprudence.

Third, the court erred 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. Legislative rules, by their nature, have legal effect, "bind members of the agency and the public," and receive "substantial deference from courts." *Sweet v. Sheahan*, 235 F.3d 80, 91 (2d Cir. 2000). Legislative rules are "powerful" and "can impose obligations on members of the public distinct from, and in addition to, those imposed by statute." *Id.*; *see also National Ass'n of Home Builders v. United States Army Corps of Eng'rs*, 417 F.3d 1272, 1285 (D.C. Cir. 2005) ("[l]egislative

rules are those that grant rights, impose obligations, or produce other significant effects on private interests") (internal quotation marks omitted). Because the difference between legislative and interpretive rules bears directly on the nature and extent of change in the legal landscape wrought by a rule, the distinction is plainly relevant to retroactivity analysis. *See Landgraf*, 511 U.S. at 270 (in determining whether a law has retroactive effect, a "court must ask whether the new provision attaches new *legal consequences* to events completed before its enactment," which is a judgment that "comes at the end of a process of judgment concerning *the nature and extent of the change in the law*") (emphases added).

C. This Case Is An Appropriate Vehicle To Address These Important Legal Issues

This case presents substantial jurisprudential issues of great practical importance. Taken together, *Bowen* and *Landgraf* impose important restraints on the authority of agencies to promulgate rules with retroactive effect. The decision below, as well as those of courts of appeals that have aligned themselves with the Third Circuit, will encourage agencies to circumvent this Court's decisions by classifying their actions as "clarifications" subject to neither the *Bowen* rule nor the *Landgraf* retroactivity principles.

As a practical matter, allowing that erosion of *Bowen* and *Landgraf* to continue will afford agencies increasing latitude to manipulate the outcome of pending litigation and to alter the legal consequences of past conduct through mere regulatory fiat. Those outcomes directly conflict with the core principles animating the longstanding presumption against retroactivity. *See, e.g.*, *Landgraf*, 511 U.S. at 265-

66; *Eastern Enters.*, 524 U.S. at 532-33 (plurality) (collecting authority); *St. Cyr*, 533 U.S. at 315 (noting that "[r]etroactive statutes raise special concerns" because of risk that "political pressures" will "tempt[]" decisionmakers "to use retroactive legislation as a means of retribution against unpopular groups or individuals"). Given the fundamental values advanced by retroactivity rules, this Court's review here is needed to bring uniformity and to secure clarity with respect to when agency rules are in fact retroactive and therefore subject to *Bowen*'s proscription of retroactive rulemaking.

This case is an ideal vehicle for this Court to address these issues. It squarely presents three related conflicts, each of which is likely outcome-determinative here. The issues presented are pure questions of law that involve, among other things, the proper application of this Court's decisions in *Bowen* and *Landgraf*. The legal issues, moreover, were fully briefed before the district court and the court of appeals, and passed upon by the lower courts. There is accordingly no reason for this Court to delay in resolving the important questions presented.

II. THE THIRD CIRCUIT'S HOLDING THAT CONGRESS DELEGATED TO THE SEC NEAR PLENARY AUTHORITY TO EXEMPT TRANSACTIONS FROM SECTION 16(b) WARRANTS REVIEW BY THIS COURT

The Third Circuit held that new Rule 16b-3, which exempts all transactions between either officers or directors and issuers regardless of a compensatory purpose from the prohibition on short-swing transactions, "is a permissible construction of section 16(b) and a valid exercise of the SEC's congressionally

delegated authority." Pet. App. 24a. That judgment is incorrect: Congress did not provide the SEC plenary authority to exempt transactions from Section 16(b); rather, any exemption must be "comprehended within the purpose" of that section. 15 U.S.C. § 78p(b). Section 16(b)'s purpose is to prohibit *any* profiteering from short-swing transactions, not merely to ban transactions involving informational asymmetries. Because new Rule 16b-3 creates an exemption that is contrary to, and not "comprehended within," the purpose of Section 16(b), the Third Circuit erred in concluding that the rule is a valid exercise of delegated authority. That error affects a crucial regulation of market practices that could negatively affect the stability of the markets and thus warrants this Court's attention.

A. The SEC's New Rule 16b-3 Conflicts With The Purposes Of Section 16(b)

Congress intended Section 16(b) broadly to prevent all profiteering from short-swing transactions. Section 16(b) provides the SEC only limited authority to exempt from the statute's reach those transactions that are "not comprehended within the purpose" of the section. 15 U.S.C. § 78p(b). Because the text and history of Section 16(b), as well as judicial decisions interpreting that provision, make clear that Congress's overriding objective was to curb nearly all short-swing insider transactions, including the type of short-swing trading that occurred here, new Rule 16b-3 is an invalid exercise of the SEC's authority.

1. A proper understanding of Section 16(b)'s purpose must begin from the presumption that Congress intended the securities laws to advance "broad remedial goals." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976). Although "[t]he ultimate question is

one of congressional intent," *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979), this Court has time and again observed that "Congress intended securities legislation . . . to be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)).

Viewed against that background understanding, the statutory text strongly indicates that Congress intended for Section 16(b) to reach broadly the type of speculative short-swing transactions that took place here. The prohibition in Section 16(b) is notable both in its breadth and in its mandatory nature: under that section, "*any* profit" that an insider acquires from a transaction "within any period of less than six months . . . *shall inure* to and be recoverable by the issuer" without regard to the "intention" of the insider. 15 U.S.C. § 78p(b) (emphases added).

Moreover, the Exchange Act's structure supports the conclusion that the SEC has only limited authority to create exemptions from Section 16(b). Unlike many other provisions of the Exchange Act, Section 16(b) is noteworthy for its rigidity and the fact that it left virtually no room for interpretation or interference by the SEC. *See* Thel, 42 Hastings L.J. at 400-01; *see also* Karl Shumpei Okamoto, *Rereading Section 16(b) of the Securities Exchange* Act, 27 Ga. L. Rev. 183, 227 (1992) (noting that, "[w]hile the other provisions" of the Exchange Act "are generally not self-implementing, section 16 contains substantive prohibitions which do not require administrative

rulemaking for implementation").[4] Indeed the SEC has no independent authority to enforce Section 16(b). *See Gollust v. Mendell*, 501 U.S. 115, 122 (1991).

2. The legislative history bolsters the conclusion that Section 16(b) is intended to curb *speculation* and to do so by banning *all* short-swing trades by insiders. The Exchange Act's authors viewed speculation as one of the principal evils contributing to the 1929 stock market crash. *See* Okamoto, 27 Ga. L. Rev. at 222-24; Thel, 42 Hastings L.J. at 458-59. In enacting the statute, "Congress' goal was to restore eroded investor confidence in the integrity of the market, and the technique it chose was a sweeping removal of any profit motive for . . . 'sure-thing' speculation." *Wagman v. Astle*, 380 F. Supp. 497, 501 (S.D.N.Y. 1974). Section 16(b) was a major provision of the securities law reform movement of the 1930s, and its forfeiture requirement was intended to apply broadly and unambiguously as a prophylactic. *See Lewis v. Varnes*, 505 F.2d 785, 787-88 (2d Cir. 1974).

Section 16(b) was thus designed "to discourage insiders from buying stock, but not so much from

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[4] The first sentence of Section 16(b), moreover, sets forth part of the statutory purpose — namely, "preventing the unfair use of information which *may* have been obtained by [a] beneficial owner, director, or officer by reason of his relationship to the issuer." 15 U.S.C. § 78p(b) (emphasis added). The text makes clear that the prohibition in Section 16(b) is not confined simply to trading on non-public information; rather, it reaches *all* insiders regardless of whether they have made use of inside information. Indeed, new Rule 16b-3 conflicts with even a narrow understanding of Section 16(b) as limited to addressing the improper use of inside information because the new rule permits an insider to profit from that information through transactions in company stock and provides the insider with an incentive to manipulate company affairs so as to take advantage of price fluctuations.

buying on inside information as from buying on speculation." Thel, 42 Hastings L.J. at 414. Congress viewed short-swing trading by insiders as an evil in itself, rife with potential for manipulation. Such manipulation had led to price volatility, often sending false signals about the value of companies, which in turn rattled investor confidence and allowed insiders to exploit artificially depressed prices. *See* Okamoto, 27 Ga. L. Rev. at 226.

The legislative history therefore evinces a broad concern with curbing short-swing transactions by insiders. For instance, Senator Duncan Fletcher, who sponsored the Exchange Act, noted that Section 16(b) would forbid "directors, officers, and principal stockholders . . . to speculate in the securities of [their own] corporation." 78 Cong. Rec. 2270, 2271 (1934). Similarly, Thomas Corcoran explained the bill's primary purpose as preventing "short-term speculative swings on the securities of [insiders'] own companies." *Stock Exchange Practices: Hearings on S. Res. 84 (72d Congress) and S. Res. 56 and S. Res. 97 (73d Congress) Before the S. Comm. on Banking and Currency*, 73d Cong. 6556-57 (1934). Accordingly, Corcoran explained that the element of intent or expectation had been dropped from the original draft of the bill, so as to prevent *all* short-swing trades and to mandate forfeiture of *all* short-swing profits. *See id.*

3. This Court's decisions strengthen the conclusion that Section 16(b)'s "purpose" is to prevent short-swing trading, writ large, by insiders. The Court has repeatedly acknowledged the statute's dual purposes: (1) preventing *insider trading* (that is, trading on non-public information) by officers, directors, and principal beneficial owners; and (2) preventing *short-*

swing trading by officers, directors, and beneficial owners. In *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972), for example, this Court noted that Section 16(b) sweeps far more broadly than simply preventing insiders from trading on non-public information (as the SEC and the Third Circuit assumed):

> In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect.

Id. at 422 (internal quotation marks omitted). This Court has repeatedly underscored that Congress sought broadly to "curb[] short-swing speculation," *id.* at 424, and to "impose[] liability without fault," *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 251 (1976). Against that backdrop, *Levy I* correctly interpreted Rule 16b-3's exemption narrowly. *See* Pet. App. 97a-98a.

For these reasons, the text and history of Section 16(b), as well as this Court's decisions interpreting it, establish that Section 16(b)'s "purpose" is to prevent any profiteering on short-swing transactions. Because the "intent of Congress is clear" with regard to the "purpose" of the statute, "that is the end of the matter." *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984). Congress

intended for Section 16(b) to cover the conduct at issue here: short-swing trading by an insider.

New Rule 16b-3, which is premised on the view that Section 16(b) is aimed only at transactions involving information asymmetries, therefore represents an unlawful construction of Section 16(b)'s "purpose." Indeed, new Rule 16b-3 undermines both of the core purposes of Section 16(b) by enabling insiders to engage in trading on inside information in their own company's stock and by creating incentives for insiders to manipulate their company's affairs to benefit from price fluctuations. The Third Circuit erred in according *Chevron* deference to the SEC's enactment of that rule pursuant to Section 16(b).[5]

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[5] Once the purpose of Section 16(b) is properly understood, the SEC's justifications for new Rule 16b-3 are unresponsive. For example, in promulgating new Rule 16b-3, the SEC explained that transactions between insiders and issuers do not usually present opportunities for insiders to realize profits at the expense of uninformed shareholders. *See* 70 Fed. Reg. at 46,083. But that is beside the point: Section 16(b)'s primary purpose is not to function as a remedial statute for shareholders or to guard against informational asymmetries but to promote market stability by banning profiteering from all short-swing transactions.

The SEC also relied on the requirement of obtaining board approval to argue that the transactions in question do not present a risk of speculative abuse. *See id.* at 46,082. But the SEC has never explained how this gate-keeping function will prevent the kind of speculation that the statute and its drafters sought to prevent. Moreover, in enacting Section 16(b), Congress specifically denied boards of directors the ability to prevent shareholder lawsuits to recover short-swing profits. *Accord Burks v. Lasker*, 441 U.S. 471, 484 n.13 (1979).

B. The Court Should Grant Certiorari To Clarify The Scope Of An Important Provision Of Securities Law

New Rule 16b-3 threatens to undermine the efficacy of an important and longstanding securities regulation. Instead of construing Section 16(b) as Congress intended, the SEC has adopted a narrow understanding of Section 16(b)'s purposes that will invite the very behavior that Congress sought to prevent. The prevalence of short-swing trading and the increasing importance of securities regulation militate in favor of this Court's intervention now to clarify an important area of securities law.

Given the important functions served by Section 16(b), this Court's intervention is crucial to ensure that Rule 16b-3 does not undermine the statute's principal purpose of preventing short-swing trading and speculative manipulation by insiders. Particularly in the current economic climate, clarity regarding the scope and import of securities laws is of paramount importance.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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