No. 01-147

In the Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

CHARLES ZANDFORD

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR THE
SECURITIES AND EXCHANGE COMMISSION

PAUL D. CLEMENT
Acting Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

In the Supreme Court of the United States

No. 01-147

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

CHARLES ZANDFORD

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR THE
SECURITIES AND EXCHANGE COMMISSION

Section 10(b) and Rule 10b-5 prohibit "(1) using any deceptive device (2) in connection with the purchase or sale of securities." *United States* v. *O'Hagan*, 521 U.S. 642, 651 (1997). Respondent violated those provisions both when he sold, for his own benefit, securities that the Woods had entrusted to him as their stockbroker and fiduciary *and* when he converted the sales proceeds to his own use, all without disclosure or authorization.

1. **Respondent's Sales Of The Woods' Securities For His Own Benefit Were Fraudulent, And That Fraud Was Inherently "In Connection With" The Sales**

Respondent concedes (Br. 34) that the "in connection with" requirement is satisfied if his sales of the Woods' securities were themselves fraudulent. Those sales were indeed fraudulent. See Gov't Br. 15-19. The court of appeals recognized, and respondent apparently does not contest, that he was the Woods' fiduciary because he had discretionary authority to invest on their behalf. See Pet. App. 14a; 8 L. Loss & J. Seligman, *Securities Regulation* 3826 (3d. ed. 1991). As the Woods' fiduciary, respondent had a duty to act only for their benefit when selling securities in their accounts. See Restatement (Second) of Agency § 387; *id.* § 425 & cmt. f. He also had a duty to disclose to the Woods all information pertinent to his handling of their accounts—including any conflict of interest that he had in selling their securities. See *id.* § 381; *Hughes* v. *SEC*, 174 F.2d 969, 975-976 (D.C. Cir. 1949) (stockbroker having fiduciary relationship with clients had duty to disclose conflict of interest in recommending or executing transactions, and failure to disclose violated Section 10(b)).

Thus, when respondent secretly sold the Woods' securities for his own purposes, he simultaneously breached his fiduciary duty and committed fraud. See *O'Hagan*, 521 U.S. at 653-654 (fiduciary who pretends loyalty to principal while secretly converting principal's property for personal gain defrauds principal); C.H. Meyer, *The Law of Stockbrokers and Stock Exchange* § 136, at 552 (1931) (stockbroker's wrongful sale of customer's stock is conversion); *Sherman* v. *State*, 124 Tex. Crim. 205, 208 (1933) (per curiam) (agent's sale of stock with intent to misappropriate proceeds is embezzlement of stock itself).

a. Respondent erroneously contends that the sales were not fraudulent because he "was authorized, by virtue of the discretionary nature of the Woods' account, to engage in securities transactions without specific authorization for each transaction." Br. 38. Under the agency principles discussed above, discretionary authority does not give the broker license to use a client's assets *for his own enrichment.* Discretionary authority to invest extends only to actions *in the principal's interest* and consistent with his instructions.

See *Sherman*, 124 Tex. Crim. at 207-208 ("Notwithstanding that appellant may have had authority to make the sale of the stock alleged to have been embezzled, yet, if he sold the same with the formed intention to defraud the owner and to convert the proceeds to his own use and benefit, he is as much guilty of embezzlement of the stock as if he had no authority to make such sale."); *Norris & Hirshberg, Inc.* v. *SEC*, 177 F.2d 228, 231-232 (D.C. Cir. 1949) (firm liable under Section 10(b) for "omission to fully disclose its trading practices and its adverse position to its customers," including fifteen who "had given petitioner express discretionary powers over their accounts"); *Bennett* v. *Hungate*, 291 F. 895, 898 (S.D.N.Y. 1922) (L. Hand, J.) (agent authorized to "invest" money for a friend "in sound investments" was not authorized to buy stock on margin); p. 9, *infra* (discussing churning cases). It would be contrary to general agency principles—not to mention common sense—to hold that a customer's authorization for a stockbroker to make investments on the customer's behalf authorizes the broker to sell them for the broker's own benefit.

b. Respondent asserts that the SEC's position "depends on the odd notion that [respondent] would have committed actionable * * * securities fraud if * * * he had intended to convert the proceeds [at the time of the sales] but then changed his mind." Br. 34; see also Resp. Br. 40. That assertion is unfounded.

First, the SEC's argument in *this* case does not depend on any such "notion" because respondent did not change his mind—he carried out his intent to convert the proceeds. Second, there is nothing "odd" about the principle that a sale of securities with wrongful intent constitutes an actionable fraud in its own right. That conclusion does not "stretch[] fiduciary principles" (Br. 37); it follows directly from them. See *Sherman*, 124 Tex. Crim. at 208 (otherwise, "someone who sold property entrusted to him for sale and absconded with the proceeds, on being accused of embezzlement of the proceeds of the sale, will defend on the theory that what he embezzled was the property itself, and vice versa"); Meyer, *supra*, § 136 at 554, 557 (broker's wrongful sale of securities is a conversion even when customer is credited with sales proceeds); W. La Fave, *Criminal Law* § 8.6, at 827 (3d ed. 2000) (someone who converts property entrusted to him with fraudulent intent is guilty of embezzlement even if he later returns the property or if he intended to and does return property of equivalent value). Indeed, this Court endorsed a similar principle more than 75 years ago when it held that a fiduciary who leased a minor's property with a secret agreement that the fiduciary would have a partial interest in the lease committed fraud whether or not the minor was injured by the lease, because "[i]t is sufficient to establish that the fiduciary has exercised his power of disposition for his own benefit without more." *United States* v. *Dunn*, 268 U.S. 121, 131 (1925).[1]

c. Respondent also contends that the undisclosed intent to convert the proceeds cannot render a sale fraudulent because non-disclosure must refer to withheld "facts," "not wholly subjective intentions." Br. 38. That contention cannot be reconciled with this Court's recent ruling in *The Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 532 U.S. 588 (2001), that the sale of an option with a secret intent

---

[1] A private plaintiff seeking damages might not be able to recover under Section 10(b) based solely on a sale with the intent to convert the proceeds: such a plaintiff must prove injury resulting from the deception (see note 3, *infra*), and, if the sales price was fair and the proceeds were not converted, there might be no injury. The government, however, need not show injury to state a claim under Section 10(b), but only that the defendant, with scienter, used deception "in connection with the purchase or sale of any security." Of course, when a stockbroker does not carry through with his intent to convert the proceeds, the government may have more difficulty proving that he had that intent at the time of the sale.

not to honor it violates Section 10(b). Nor can it be reconciled with the well-established principle that fraud may be based on the undisclosed intent not to perform a promise. See *Durland* v. *United States*, 161 U.S. 306, 312-314 (1896); Restatement (Second) of Torts § 530 cmt. c (1977).

Respondent attempts to reconcile his argument with *Wharf* and general tort principles by contending that the failure to disclose a breach of a "generalized promise[] to act as a faithful fiduciary" cannot constitute deception prohibited by Section 10(b). See Resp. Br. 39 (quoting *Pross* v. *Katz*, 784 F.2d 455, 458 (2d Cir. 1986)). That contention is based on a misinterpretation of this Court's decision in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). Some court of appeals decisions (including *Pross* and two others cited by respondent (Br. 39)) initially interpreted *Santa Fe* as holding that deception concerning a breach of fiduciary duty cannot support a Section 10(b) action. Subsequent decisions of this Court, however, have made clear that those court of appeals decisions were incorrect. *Santa Fe* holds only that there can be no violation of Section 10(b) without deception; it does not hold that a breach of fiduciary duty that involves deception cannot form the basis for a violation. See *O'Hagan*, 521 U.S. at 655. Indeed, in *O'Hagan*, this Court upheld a criminal conviction under Section 10(b) and Rule 10b-5 based on the defendant's failure to disclose that he was acting in breach of his fiduciary duty. See also *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1090-1098 (1991).[2]

[2] Despite its misinterpretation of *Santa Fe*, the Second Circuit recognized in *Pross* that fraudulent conversion of securities sometimes violates Section 10(b). The court held that "a securities transaction that entails as one of its integral steps the fraudulent securing of blank signature pages for purposes of a later conversion" is "a fraud 'in connection with the purchase or sale' of securities,'" and it remanded the case to allow the plaintiff to amend his complaint to include those allegations. 784 F.2d at 459.

2. Respondent's Conversion Of The Proceeds Of The Securities Sales Was Fraud "In Connection With" The Sales

Respondent also committed fraud when he misappropriated the proceeds of his sales of the Woods' securities while continuing the pretense that he was acting as a loyal fiduciary. See *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 10 & n.7 (1971); *Grin* v. *Shine*, 187 U.S. 181, 189 (1902); Gov't Br. 15-18. That fraud was "in connection with" the sales of the Woods' securities, because respondent made the sales in order to generate the proceeds that he planned to embezzle. See *id.* at 21-22.

a. Respondent argues (Br. 23-25) that his fraudulent conversion of the proceeds was not "in connection with" the sales because his deception did not "pertain[] to the securities themselves." Br. 24 (quoting *Chemical Bank* v. *Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir.) (Friendly, J.), cert. denied, 469 U.S. 884 (1984)). The contention that Section 10(b) prohibits only affirmative misrepresentations or material omissions that pertain to the securities themselves finds no support in the text of the "in connection with" requirement and is refuted by this Court's decisions in *O'Hagan* and *Bankers Life*. See Gov't Br. 39-41. The deception in *O'Hagan* pertained to the fiduciary's loyalty to his principal, not to any attributes of the securities that he purchased. 521 U.S. at 652. And the deception in *Bankers Life*, like one of respondent's deceptions here, pertained to the fiduciaries' intent to misappropriate the proceeds of the transaction, not to any attributes of the securities that were sold. 404 U.S. at 9. Respondent's proposed limitation on the scope of Section 10(b) would undermine the securities laws, because it would exclude from the statute's scope many pernicious forms of fraud, including frauds by brokers that the courts of appeals have uniformly held are covered. See Gov't Br. 41-43.

Indeed, even the Second Circuit's decision in *Chemical Bank* did not hold that the deception must "pertain to the securities themselves" in the narrow sense that respondent urges. See 726 F.2d at 943-944 & n.24 (distinguishing, *inter alia*, *A.T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (discussed at Gov't Br. 13, 40)).[3] And, in subsequent decisions, the Second Circuit has found actionable under Section 10(b) fraud that relates to the consideration for the sale, which would not be encompassed by the narrow interpretation of the "in connection with" requirement that respondent seeks to draw from *Chemical Bank*. See *SEC* v. *Drysdale Sec. Corp.*, 785 F.2d 38 (2d Cir.) (misrepresentations about financial condition of broker-dealer were actionable under Section 10(b) where they directly related to broker-dealer's ability to carry out its obligations to repurchase securities), cert. denied, 476 U.S. 1171 (1986); see also *Press* v. *Chemical Inv. Servs. Corp.*, 166 F.3d 529, 537 (2d Cir. 1999) (rejecting position that omission that "did not pertain to the security itself nor to its value * * * was not 'in connection with' the sale"). Respondent's fraudulent sales of securities for his own benefit and his subsequent

[3] The import of *Chemical Bank* is further clouded by the fact that the court at one point described its holding as being that the plaintiff "failed to establish the 'loss causation' necessary for a legally sufficient claim under § 10(b)." 726 F.2d at 943 n.23. The court apparently confused the requirement that a private plaintiff seeking damages show that the defendant's deception caused him a loss with the "in connection with" requirement. The "in connection with" requirement, which applies to all litigants, including the government, is, however, "analytically distinct" from the "loss causation" requirement, which applies only to private plaintiffs who seek damages. 8 Loss & Seligman, *supra*, at 3686. Fraud may occur "in connection with" a securities transaction even when it does not "cause [the] specific injury or loss" alleged. *Ibid.*

embezzlement of the proceeds thus violated Section 10(b) under Second Circuit precedent because they involved fraud concerning the consideration (*i.e.*, the proceeds) that the Woods' were to receive from the sales.

b. Respondent also incorrectly contends (Br. 25-26) that his embezzlement of the proceeds of the securities sales was not "in connection with" the sales because he had discretionary trading authority. A stockbroker is not granted immunity from Section 10(b) because his customers give him discretionary authority to handle their investments. Indeed, discretionary authority has the opposite effect, because it establishes the broker's status as fiduciary and his consequent continuing duty to disclose actions contrary to the customers' interests, including his diversion of sales proceeds from his customers to himself. See pp. 1-2, *supra*. Respondent's contrary theory would leave unprotected those brokerage customers most in need of protection. See Gov't Br. 30.

Respondent relies on two Seventh Circuit cases. Br. 26 (citing *O'Brien* v. *Continental Illinois Nat'l Bank & Trust Co.*, 593 F.2d 54 (1979); *Congregation of the Passion, Holy Cross Province* v. *Kidder Peabody & Co.*, 800 F.2d 177 (1986)). *O'Brien* is inapposite because it concerned whether an implied private right of action should be recognized under the circumstances—a question that may be informed by "policy considerations," *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737 (1975)—rather than (as here) whether Section 10(b) prohibits the conduct at issue, which is resolved by the statutory text and purposes. *Congregation of the Passion* essentially followed *O'Brien*. Moreover, to the extent that those Seventh Circuit decisions concerned the scope of Section 10(b) itself, their reasoning cannot be reconciled with this Court's subsequent decision in *O'Hagan* (or, as explained below, with the Seventh Circuit's recognition that churning violates Section 10(b)). The Seventh

Circuit reasoned in *O'Brien* that a client who has given an agent discretionary authority to invest cannot sue under Section 10(b) for fraudulent breaches of the agent's fiduciary duty because those breaches do not induce the client to make any investment decision and enforcement of fiduciary duties is a concern of state law. See 593 F.2d at 60, 63. In *O'Hagan*, however, the deception was the fiduciary's pretense of loyalty to his principal while he acted contrary to his fiduciary duty, 521 U.S. at 652, and that deception did not induce any investment decision by the principal. Indeed, the principal, unlike the Woods here, was not even a party to the relevant securities trades.

Respondent's contention based on the discretionary nature of the Woods' account is also contradicted by his concession (Br. 34) that "churning" violates Section 10(b). "Churning occurs when a securities broker engages in excessive trading in disregard of his customer's investment objectives for the purpose of generating commission business." *Ibid.* (quoting 8 Loss & Seligman, *supra*, at 3874). A required element of a churning claim is that the alleged wrongdoer controlled trading in the account. See *Armstrong* v. *McAlpin*, 699 F.2d 79, 90 (2d Cir. 1983); *Costello* v. *Oppenheimer & Co.*, 711 F.2d 1361, 1368 (7th Cir. 1983); *Carras* v. *Burns*, 516 F.2d 251 (4th Cir. 1975). The requisite "[c]ontrol is clearly established where the account is discretionary, a power of attorney has been executed in favor of the broker, and the trades completed without prior approval by the customer." *Costello*, 711 F.2d at 1368; 8 Loss & Seligman, *supra*, at 3877. Although respondent concedes that churning is covered by Section 10(b), he never explains how that concession is consistent with his position that his conduct is not covered.

c. Respondent's attempt to distinguish *Bankers Life* fails for similar reasons. As respondent acknowledges (Br. 27, 29), the Court held in *Bankers Life* that the "in connection with" requirement was satisfied when corporate insiders induced the corporation to sell its securities by "dup[ing] [it] into believing that it, the seller, would receive the proceeds." 404 U.S. at 9. Respondent argues that *Bankers Life* differs from this case because "the seller 'needed to authorize the sale in *Bankers Life*' and was deceived into doing so," Resp. Br. 28 (quoting Gov't Br. 30), but respondent "could buy or sell securities for the Woods' account without obtaining specific authorization for each transaction" (*ibid.*). Respondent's proffered distinction thus relies on his untenable theory that a stockbroker's possession of discretionary authority insulates the broker from any claim that he has defrauded his customers in violation of Section 10(b). Respondent also ignores the fact that his failure to disclose his plans and actions deprived the Woods of the opportunity to prevent his sales of their securities. His deception was thus instrumental to those sales, just as the misrepresentation in *Bankers Life* was instrumental to the sale in that case.[4]

3. The "In Connection With" Requirement Is Satisfied Because Respondent's Deception And Securities Sales Were Integral Parts Of The Same Fraudulent Scheme

a. Contrary to respondent's contention, the Court need not decide in this case the question whether "all broker conversions of client funds or securities violate § 10(b)." Resp. Br. 9. Respondent did much more than just convert customer assets, and the Court can conclude that he violated Section 10(b) and Rule 10b-5 without deciding that every stockbroker conversion of customer assets violates those

---

[4] Respondent correctly disclaims (Br. 28-29) any distinction based on the fact that the defendants in *Bankers Life* made an affirmative misrepresentation while respondent's deception involved material omissions. Any such distinction is unsupportable. See Gov't Br. 30.

provisions. Respondent fraudulently sold securities, which he had promised to buy and sell for the benefit of his customers, for the secret purpose of misappropriating the proceeds, and then fraudulently embezzled the proceeds as he had planned. Both frauds were "in connection with" the securities sales because the frauds and the sales were integral parts of the same scheme.[5]

b. Respondent argues that the "in connection with" language requires that the fraud "pertain to" (Br. 11), be "part of," or "affect" a securities transaction (Br. 12), or that there be "a close" or "direct link" (Br. 13) between the fraud and the transaction. Those suggested criteria are satisfied here. Respondent's fraud "pertain[ed] to," was "part of," and "affected" the sales both because the sales, secretly made for his own benefit, were fraudulent, and because the proceeds were diverted to respondent in furtherance of his fraudulent scheme rather than transmitted to the Woods, who ended up with nothing in return for the securities that they sold. It is hard to imagine a more "direct link" between fraud and securities sales than when the sales were a fraud on the seller,

---

[5] Respondent erroneously suggests (Br. 8, 40, 41) that the sales were not integral to his scheme because he was in a position to embezzle the Woods' money before investing it in securities. Because respondent in fact sold securities to effect his fraud, see Pet. App. 28a-29a, he cannot escape responsibility by establishing that he could have used other means. The complaint alleges that respondent began his scheme several months *after* the Woods opened the account, by which time he presumably had invested their money. See *id.* at 27a-28a (account was opened "[i]n September 1987," and respondent's "fraudulent scheme began in May 1988, shortly after Wood was hospitalized as a result of his stroke," when respondent embezzled $41,000 by selling mutual fund shares). Respondent could not, in any event, have misappropriated all of the Woods' assets without selling securities, because the Woods entrusted him with not only cash but also a bond worth more than $200,000. See 7 Tr. 178-179, *United States* v. *Zandford*, Crim. No. WN-94-0165 (D. Md. July 18, 1995) (respondent's testimony).

were made with the fraudulent intent to embezzle the proceeds, and were necessary to generate the funds that were then embezzled.

Respondent is mistaken, however, in his restrictive glosses on the phrase "in connection with the purchase or sale of any security." Neither of the books on English grammar that he cites supports his narrow reading. One generally describes the role of prepositions, B. & C. Evans, *A Dictionary of Contemporary American Usage* 386-388 (1957), and the other condemns the phrase "in connection with" as "flabby English," and states that "vagueness and pliability [are] its only merits." H.W. Fowler, *A Dictionary of Modern English Usage* 105 (2d ed. 1965). A "connection" is a "junction," "union," or "relationship." *Webster's New International Dictionary* 565 (2d ed. 1934). Thus, the plain meaning of "in connection with" supports the SEC's position that the requirement is met when the fraud and the purchase or sale are joined or related to one another in the same fraudulent course of conduct—"when the proscribed conduct and the sale [or purchase] are part of the same fraudulent scheme." Gov't Br. 19 (quoting *Alley* v. *Miramon*, 614 F.2d 1372, 1378 n.11 (5th Cir. 1980) (Wisdom, J.)).[6]

Respondent quibbles (Br. 30) that "the SEC has read too much into" this Court's description, in its unanimous opinion in *Bankers Life*, 404 U.S. at 12-13, of the "in connection with" clause as encompassing all fraud "touching" a securities trans-

[6] Respondent contends that the SEC's interpretation of the "in connection with" requirement means that Section 10(b) "would apply to an employee who stole stock certificates from his or her employer and sold them." Br. 34. The SEC's interpretation would indeed cover an employee, such as a pension fund manager, who, while secretly intending to misappropriate the proceeds, sold securities that the employer had entrusted to him to manage. It would not, however, cover an employee who stole stock certificates from his or her employer and sold the stock if there was no deception involved.

action. See also *Santa Fe*, 430 U.S. at 475-476. The SEC, however, relies on *Bankers Life*'s use of "touching" for the very purpose that respondent concedes it was intended—"to highlight the breadth the case advocated in interpreting the requirement." See Resp. Br. 31 (quoting *In re Ames Dep't Stores Inc., Stock Litig.*, 991 F.2d 953, 964 n.5 (2d Cir. 1993)).

Respondent similarly errs in contending that the SEC improperly "equates the purposes of § 10(b) with the broad purpose of pervasive securities industry regulation." Br. 19; see Br. 14 n.7. Rather, the SEC follows the principle respondent advocates elsewhere of "us[ing] the purposes of the statute to discern" the meaning of the "in connection with" requirement. Br. 32 n.27. This Court has likewise construed Section 10(b) in light of the purposes underlying the Exchange Act, including the goal of "insur[ing] honest securities markets and thereby promot[ing] investor confidence." See *O'Hagan*, 521 U.S. at 658. It is consistent with those purposes to construe Section 10(b) to encompass respondent's conduct, because to exclude it would erode honesty and investor confidence in the securities markets, in contravention of core purposes of the Act. See Gov't Br. 24-28.

c. Respondent also contends (Br. 14-20, 32-34) that Section 10(b) does not apply to his fraudulent conduct because Section 10(b) covers only "new" forms of fraud (Br. 18) and the conduct in which he engaged does not in any event impair "market integrity or investor understanding" (Br. 19). Respondent's contention that Section 10(b) excludes traditional forms of fraud has no grounding in the text of Section 10(b) and is contradicted by precedent. This Court has repeatedly held that Section 10(b) prohibits "*all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception." *Bankers Life*, 404 U.S. at 11 n.7. Section 10(b) is a "catch-all" provision intended to reach all fraud connected with securities transactions. See, *e.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 202 (1976). Thus, respondent's embezzlement is not excluded from Section 10(b)'s purview because it is a well-recognized form of fraud. See *O'Hagan*, 521 U.S. at 654.

Moreover, stockbroker embezzlement of customer securities and securities proceeds does threaten both "market integrity" and "investor understanding" (Resp. Br. 19). Investor understanding suffers when a stockbroker deceives investors into believing that he is undertaking securities transactions for their benefit and that they will receive the proceeds of the transactions. See Resp. Br. 33 & n.29 (explaining *Bankers Life* as a case in which fraud impaired investor understanding because the seller was duped into believing it would receive the proceeds). And the integrity of the markets is called into question when a stockbroker engages in conduct that violates the "high standard of business ethics in the securities industry" that Congress sought to achieve through the securities laws. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 234 (1988).

d. Respondent appears to contend (Br. 13-22) that the SEC lacks authority to sanction stockbrokers for violations of Section 10(b)—at least for the type of fraud involved in this case—because Congress gave "primary responsibility" (Br. 15) for broker regulation to industry self-regulatory organizations, such as the National Association of Securities Dealers (NASD). On the contrary, the Exchange Act gives the SEC direct authority to bring both injunctive actions and administrative proceedings against stockbrokers who commit fraud in connection with securities transactions, and the rules of the SEC and self-regulatory organizations are complementary rather than mutually exclusive. Section 10(b) makes it unlawful for "any person" to use fraud in connection with the trading of securities, and Section 21(d)(1), 15 U.S.C. 78u(d)(1), authorizes the SEC to bring an action in court when it appears that "any person" is violating the Act. Further, the SEC may bring administrative proceedings against brokerage firms and their personnel and impose remedial sanctions on them under Section 15(b)(4) and (6), 15 U.S.C.78*o*(b)(4) and (6), and Section 21C, 15 U.S.C. 78u-3. Gov't Br. 28 n.9. The availability of disciplinary action by self-regulatory organizations does not restrict the SEC's authority to act against brokers who violate the securities laws. The SEC has taken such actions against brokers since shortly after enactment of the Exchange Act. Indeed, the first published adjudicatory decision of the SEC interpreting Section 10(b) to cover the sort of fraudulent conduct at issue in this case arose from an administrative proceeding brought by the SEC under Section 15(b). See *Kenneth Leo Bauer*, 26 S.E.C. 770 (1947).[7]

Thus, contrary to respondent's contention, the Act provides for "direct governmental regulation" (Br. 16) of matters covered by Section 10(b)—apart from any authority the NASD and the exchanges have to discipline their members. As this Court has recognized, many provisions of the federal securities laws overlap in coverage. In *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468-469 (1969), for example, the Court rejected the argument that Section 10(b) "does not cover misrepresentations which occur in connection with proxy solicitations" because Section 14 of the Exchange Act regulates proxy solicitations. The Court observed that "[t]he fact that there may be some overlap" between Section 10(b) and Section 14 "is neither unusual nor unfortunate."

---

[7] *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963), on which respondent relies (Br. 10, 15-16, 21), is inapposite. In *Silver*, the Court discussed the role of the exchanges in determining "whether and to what extent the federal antitrust laws apply to securities exchanges regulated by the * * * Exchange Act." 373 U.S. at 342. The Court in no way suggested that the powers of self-regulatory organizations implicitly limit the SEC's authority to enforce the securities laws.

Ibid. See also *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 383 (1983) (noting that same fraudulent conduct was proscribed by both Section 17(a) of Securities Act of 1933 and Section 10(b)).

For similar reasons, respondent is not aided (Br. 13) by Section 15(b)(4)(B) of the Exchange Act, 15 U.S.C. 78*o*(b)(4)(B), which specifies the types of criminal convictions that may form the basis for SEC sanctions against broker-dealers, and lists separately crimes "involv[ing] the purchase or sale of any security" (in subparagraph (i)) and crimes involving the "fraudulent conversion, or misappropriation of funds, or securities" (in subparagraph (iii)). There is substantial overlap among the descriptions of a number of the crimes covered by Section 15(b)(4)(B). Compare, *e.g.*, 15 U.S.C. 78*o*(b)(4)(B)(i) (covering crimes involving "taking of a false oath, the making of a false report, bribery, [or] perjury") with U.S.C. 78*o*(b)(4)(B)(iv) (covering violations of 18 U.S.C. 152, which criminalizes those actions in bankruptcy proceedings), and 15 U.S.C. 78*o*(b)(4)(B)(i) (covering crimes involving "the purchase or sale of any security") with 15 U.S.C. 78*o*(b)(4)(B)(ii) (covering crimes arising out of conduct of the business of a broker or dealer). Thus, subparagraph (iii)'s reference to crimes involving "fraudulent conversion * * * of funds, or securities," does not imply that some such crimes are not also encompassed by subparagraph (i)'s reference to crimes involving "the purchase or sale of any security."

In any event, Section 15(b)(4)(B) applies only to broker-dealers, and subparagraph (iii) was adopted as an amendment to the Exchange Act in 1964. See Pub. L. No. 88-467, 78 Stat. 571. The fact that Congress, when it amended Section 15(b) in 1964, listed crimes involving fraudulent conversion of securities or funds separately from crimes involving the purchase or sale of any security does not suggest that, when an earlier Congress enacted Section 10(b) in 1934, it intended to exclude fraudulent conversion of securities or proceeds from the coverage of that catch-all antifraud provision, which applies to "any person."

4. The SEC's Longstanding Interpretation Of Section 10(b) And Rule 10b-5 Is Entitled To Deference

Respondent mistakenly contends (Br. 42-48) that the SEC's interpretation of Section 10(b) and Rule 10b-5 is not entitled to deference. As our opening brief explains (at 37-39), Section 10(b) contains "an express delegation of authority to the [SEC] to elucidate" Section 10(b) through "rules and regulations," and the Exchange Act authorizes the SEC to interpret the Act (including Section 10(b)) through "formal adjudication." *United States* v. *Mead Corp.*, 121 S. Ct. 2164, 2171, 2173 (2001); 15 U.S.C. 78j(b), 78o(b)(4)(D) and (6)(A)(i). Under *Chevron U.S.A. Inc* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), as clarified in *Mead*, the SEC's interpretation of Section 10(b) and Rule 10b-5, expressed in its published adjudicatory opinions such as *Kenneth Leo Bauer*, 26 S.E.C. 770 (1947), is "binding in the courts unless * * * manifestly contrary to the statute." 121 S. Ct. at 2171. The SEC's longstanding interpretation is also entitled to considerable weight under deference principles that predate *Chevron* and *Mead*. See Gov't Br. 38-39 (citing, *inter alia*, *Norwegian Nitrogen Prods. Co.* v. *United States*, 288 U.S. 294, 315 (1933)).

a. There is no merit to respondent's suggestion (Br. 43, 44, 45) that the SEC has somehow waived its deference argument because it has not previously sought or received *Chevron* deference in this Court's Section 10(b) cases. Congress has granted the SEC authority to take "administrative action with the effect of law." *Mead*, 121 S. Ct. at 2172. That authority cannot have been surrendered by the SEC's litigation decisions not to rely on it in previous cases. Indeed, many of those cases (unlike this one) involved SEC interpretations of Section 10(b) that were not embodied in formal adjudications, *e.g.*, *O'Hagan*. Moreover, the Court has deferred to the SEC's interpretation of Section 10(b) on at least one occasion, albeit without specifying the kind of deference that the Court was applying. See *Basic Inc.*, 485 U.S. at 239 n.16 (giving SEC's interpretation "due deference").

b. Respondent incorrectly suggests (Br. 44) that the Court decided in *O'Hagan* that no deference is due the SEC's interpretations of Section 10(b). *O'Hagan* does not address that question. The passage in *O'Hagan* on which respondent relies simply observes that, under Section 14(e) of the Exchange Act, the SEC is empowered to adopt prophylactic rules that proscribe "more than the core activity prohibited" by the statute, but, under Section 10(b), any implementing rule may proscribe "only conduct that § 10(b) prohibits." 521 U.S. at 673 & n.18.

Adams Fruit Co. v. *Barrett*, 494 U.S. 638 (1990) (Resp. Br. 42, 44), is also inapposite. There, the Court declined to defer to the Secretary of Labor's position that there was no private right of action under the Migrant and Seasonal Agricultural Workers Protection Act. The Court reasoned that, although the Act authorized the Secretary to promulgate standards of conduct, it entrusted administration of the private action provisions to the courts and did "not empower the Secretary to regulate the scope of the judicial power vested by the statute." 494 U.S. at 650. Here, in contrast, Congress has expressly empowered the SEC to administer the Exchange Act and to interpret Section 10(b), including its "in connection with" language.

c. Respondent also incorrectly asserts (Br. 44) that the SEC's interpretation is not entitled to deference because violations of Section 10(b) may give rise to criminal or other "non-SEC initiated" actions. This case does not involve the scope of the implied private right of action under Section

10(b), and the SEC's position here does not depend on any entitlement to deference concerning the scope of those actions. Judicial inference of a private right of action should not reduce the deference given to decisions made pursuant to interpretive authority expressly delegated by Congress. Further, although willful violations of Section 10(b) and Rule 10b-5 are criminal, 15 U.S.C. 78ff(a), interpretations of a statute and its implementing regulations by the agency charged with their administration are entitled to deference even when the statute contains criminal penalties. See *Babbitt* v. *Sweet Home Chapter of Communities For a Great Oregon*, 515 U.S. 687, 703-704 & n.18 (1995). Once an agency has issued an interpretation that particular conduct is proscribed, a criminal defendant cannot plausibly argue that he did not have reasonable notice of the interpretation. That is particularly true here, because the SEC's interpretation is longstanding and consistent.

d. Finally, there is no basis for respondent's contention (Br. 45-48) that the SEC's decisions do not warrant *Chevron* deference because they contain insufficient legal analysis. As an initial matter, the decisions contain ample legal analysis. See Gov't Br. 35-36 (summarizing analyses of *Kenneth Leo Bauer*, 26 S.E.C. at 770, and *Southeastern Sec. Corp.*, 29 S.E.C. 609 (1949)). In any event, there is no requirement that agency opinions in formal adjudications contain a certain amount or form of legal analysis in order to merit *Chevron* deference. The opinions warrant deference not because of the persuasiveness of their legal reasoning, cf. *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944), but because they are "promulgated in the exercise" of "delegated authority * * * to make rules carrying the force of law." *Mead*, 121 S. Ct. at 2171; see *Martin* v. *OSHRC*, 499 U.S. 144, 157 (1991) (deferring to interpretation by Secretary of Labor reflected in citation that triggers proceedings before OSHRC). Although respondent refers to the SEC opinions as "public announcements" (Br. 45) and cites the releases that described them (Br. 46) rather than their citations in the S.E.C. Decisions and Reports, they are official SEC opinions that resolve formal adjudications conducted in accordance with the procedures specified in 5 U.S.C. 554, 556 and 557. They are thus the product of "a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement" that "carr[ies] the force of law," and they are entitled to that weight. *Mead*, 121 S. Ct. at 2171.

* * * * *

For the foregoing reasons, and the reasons stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

PAUL D. CLEMENT
*Acting Solicitor General**

MARCH 2002

* The Solicitor General is recused in this case.