UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 07-1849

MARK LEVY,

Plaintiff-Appellant,

v.

STERLING HOLDING COMPANY, LLC., NATIONAL SEMICONDUCTOR CORPORATION, and FAIRCHILD SEMICONDUCTOR INTERNATIONAL, INC.,

Defendants-Appellees.

On Appeal from the United States District Court
for the District of Delaware

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, IN SUPPORT OF THE POSITION OF THE APPELLEES

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission submits this brief as *amicus curiae* to address the scope of the Commission's statutory rulemaking authority to exempt transactions from the "short-swing" trading profits provision in Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b). Specifically, the Commission addresses the interpretation of Section 16(b), the interpretation and validity of exemptive Rules 16b-3(d) and 16b-7, 17 C.F.R. 240.16b-3(d) and 240.16b-7, and the authority of the Commission to make certain clarifying amendments to these rules applicable to pre-amendment transactions occurring since the Commission's adoption of the provisions that it clarified.

BACKGROUND

Section 16(b) provides that "[f]or the purpose of preventing the unfair use of information which may have been obtained" by an officer, director, or beneficial owner of more than 10% of a class of an issuer's equity securities, "any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months" shall be recoverable by the issuer or by security holders seeking recovery for the issuer. Recovery may be obtained "irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction." Because Section 16(b) imposes a

stringent remedy regardless of whether the insider engaged in any wrongdoing or illegal conduct, Congress afforded protection against the statute's overreaching by vesting in the Commission the authority to exempt from Section 16(b) "any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

The transactions involved in this case, for which the defendants claim exemptions under Rules 16b-3(d) and 16b-7, occurred when an issuer's preferred stock was converted in a reclassification into common stock.

A. The Commission's Rationale for Exempting, in Rule 16b-3(d), Acquisitions of Securities by Officers and Directors from the Issuer

At the time of the transactions at issue in this case in 1999, Rule 16b-3(d) provided an exemption from Section 16(b) liability for "[a]ny transaction involving a grant, award or other acquisition from the issuer . . ." by an officer or director if any one of three alternative conditions, including approval of the transaction by the issuer's board of directors or by the shareholders, was satisfied. When the Commission adopted that version of the rule in 1996 (by replacing an earlier version), it explained that the transactions covered by the rule - - officer and director acquisitions from the *issuer* - - do not appear to present the same opportunities for insider profit on the basis of non-public information as do insiders' transactions *in the market*. "Typically, where the issuer, rather than the trading markets, is on the other

side of an officer or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute." *Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, Exchange Act Release No. 37260, 61 Fed. Reg. 30376, 30377 (June 14, 1996) ("1996 Adopting Release") (A:2966-3031); *see also Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, Exchange Act Release No. 52202, 70 Fed. Reg. 46080 (Aug. 9, 2005) ("2005 Release").

In addition, when the 1996 rule was proposed in 1995, the Commission stated, with respect to the gatekeeping procedures imposed by the rule, that the purpose of the director and shareholder approval conditions is to ensure that appropriate company gate-keeping procedures are in place to monitor any acquisitions by the insiders and to ensure acknowledgment and accountability on the part of the company concerning these acquisitions. *See Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, Exchange Act Release No. 36356, 60 Fed. Reg. 53832, 53835 (Oct. 17, 1995) ("1995 Proposing Release") (A:2957-65). Having the board or shareholders consider each transaction so there is "acknowledgment and accountability" on the part of the company provides safeguards against abuse of inside information. *See* 1995 Proposing Release, 60 Fed. Reg. at 53835 (A:2960).

The Commission also noted that "states have created potent deterrents to insider self-dealing and other breaches of fiduciary duty" by officers and directors.

1996 Adopting Release, 61 Fed. Reg. at 30377 n.17 (*citing 3 Fletcher Cyc. Corp*. § 837.60 (Perm. ed. 1994) and D. Block, S. Radin and N. Barton, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* 124-37 (4th ed. 1993)) (A:3007). Thus, the Commission said, if a self-interested board disregards the corporation's interest and engages in self-dealing, it plainly breaches its fiduciary duty and may be held liable under state law.1/

The Commission further stated when it adopted Rule 16b-3(d) in 1996 that "unlike the [pre-1996] rule, a transaction need not be pursuant to an employee benefit plan or any compensatory program to be exempt, nor need it specifically have a compensatory element." Adopting Release, 61 Fed. Reg. at 30378-79 (A.:2971).

B. The Commission's Rationale for Exempting Reclassifications in Rule 16b-7

Rule 16b-7 was entitled "Mergers, reclassifications, and consolidations" at the time of the 1999 transactions at issue here. The rule's text, however, did not include the term "reclassifications." It exempted from Section 16(b) liability the acquisition of a security pursuant to a merger or consolidation if the security relinquished was of

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1/ By its terms, Rule 16b-3(d) exempts acquisitions only by officers and directors. It is inapplicable to the third category of statutory insiders covered by Section 16(b) - - ten percent holders. The reason for the exclusion of ten percent holders, as stated in the 1996 Adopting Release, is that, although "[o]fficers and directors owe certain fiduciary duties to a corporation . . . which act as an independent constraint on self-dealing," such duties "may not extend to ten percent holders." 61 Fed Reg. at 30379 n.42

a company that owned 85% or more of either (a) the equity securities of all other companies involved or (b) the combined assets of all the companies involved. The rule is typically relied on where a company reincorporates in a different state or reorganizes its corporate structure. *See* 2005 Release, 70 Fed. Reg. at 46084.

Rule 16b-7 was first adopted effective June 9, 1952. *See Exemption of Certain Transactions from Section 16(b),* Exchange Act Release No. 4717, 17 Fed. Reg. 5501 (June 19, 1952, as corrected July 18, 1952 at 17 Fed. Reg. 6579) ("1952 Adopting Release"). The rule did not mention reclassifications in either the title or the text. In the proposing release, the Commission noted that the exempted transactions - - mergers and consolidations meeting the 85% requirement - - are of relatively minor significance to shareholders and do not present significant opportunities to insiders to profit by advance information. *See Exemption of Certain Transactions from Section 16(b),* Exchange Act Release No. 4696, 17 Fed. Reg. 3177 (April 10, 1952) (1952 proposing release). The proposing release added that "the essential determination is whether the enterprise is materially different in character from what it was prior to the merger or consolidation." *Id; see also* 1952 Adopting Release, 17 Fed. Reg. 5501 (in adopting the Rule 16b-7 the Commission similarly stated that "[t]he exemption is granted whenever a merger or consolidation does not result in any significant change in the character or structure of the company").

As originally adopted, Rule 16b-7 applied, as noted, to mergers and consolidations, but did not specifically explicitly address reclassifications. In a 1981 interpretive release, however, the Commission's staff stated that "Rule 16b-7 does not require that the security received in exchange be similar to that surrendered, and the rule can apply to transactions involving reclassifications." *Interpretive Release on Rules Applicable to Insider Reporting and Trading*, Exchange Act Release No. 18114, 1981 WL 31301, at *57 (Sept. 24, 1981) (A:2827).2/

In 1991, the Commission amended the title of Rule 16b-7, but not the rule's text, to include "reclassifications" along with mergers and consolidations. *See Ownership Reports and Trading By Officers, Directors and Principal Security Holders*, Exchange Act Release No. 28869, 56 Fed. Reg. 7242, 7273 (Feb. 21, 1991) (A:2888, 2912). The

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2/ Even before there were any Commission statements and rules regarding reclassifications under Section 16(b), courts exempted reclassifications under a court-developed doctrine which exempts transactions not considered to present the risk of insider trading at which Section 16(b) is directed. *See, e.g., Roberts v. Eaton*, 212 F.2d 82 (2d Cir. 1954); *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶97,693, 1980 WL 1460 (S.D.N.Y. Nov. 18, 1980); *Rothenberg v. United Brands Co.*, [1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,045, 1977 WL 1014 (S.D.N.Y. May 11, 1977), *aff'd*, 573 F.2d 1295 (2d Cir. 1977); *see also Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966). In endorsing what is known as the "unorthodox transaction doctrine" in 1973, the Supreme Court noted that "[t]he term ['unorthodox transaction'] has been applied to stock conversions, exchanges pursuant to mergers and other corporate reorganizations, *stock reclassifications*, and dealings in options, rights, and warrants." *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 593 n.24 (1973)(emphasis added).

1991 adopting release indicates that the change was not intended to effect any "substantive" changes to the rule, and reaffirmed the staff's 1981 view that the rule applies to reclassifications. *Id*. at 7261-62. In 2002, the Commission reiterated the view that Rule 16b-7 exempts reclassifications. *See Form 8-K Disclosure of Certain Management Transactions*, Exchange Act Release No. 45742, 67 Fed. Reg. 19914, 19919 (Apr. 23, 2002).

C. This Court's Decision in *Levy I*

In this Court's first decision in this case and the district court proceedings leading up to it ("*Levy I*"), the district court decided that acquisitions of securities pursuant to reclassifications are exempt under Rule 16b-7 and dismissed plaintiff's complaint without reaching the issue of whether Rule 16b-3 applied. *Levy v. Sterling Holding Company, LLC.*, Fed Sec L. Rep. ¶91,689, 2002 WL 187513 (D. Del. Feb. 5, 2002). Levy appealed, and on December 19, 2002, this Court reversed the district court decision, holding that neither Rule 16b-3(d) nor Rule 16b-7 exempted the reclassification here. *See Levy v. Sterling Holding Company, LLC.*, 314 F.3d 106 (3d Cir. 2002).

As to Rule 16b-7, this Court stated that the intent of the Commission governed, but that it was unable to ascertain what the Commission intended to exempt in Rule 16b-7. 314 F.3d at 112. While the Court said it was "satisfied from

[its] review of the text of Rule 16b-7 and the SEC releases" that the Rule applies to some reclassifications, "the SEC has not included all reclassifications in Rule 16b-7 and thus has not exempted *all reclassifications* from the reach of section 16(b)." *Id.* at 114 (emphasis in original). "This conclusion," the Court wrote, "requires us to determine whether the reclassification here is included in the rule." *Id.* The Court held that "[w]e are of the view that at this stage of the proceedings we must regard the conversion of the preferred stock . . . as the type of reclassification that the SEC would not have intended to exempt by Rule 16b-7." This Court accepted the plaintiff's argument that unless the insider's existing holdings in a company are exchanged for their economic equivalent, the exchange should not fall within the rule. In this regard, the Court noted, first, that the plaintiff alleged that, by virtue of the reclassification, the defendants' proportionate interests in the issuer increased. 314 F.3d at 117. Second, the Court pointed out that the reclassification of preferred to common stock changed the relative investment risks and opportunities of the shareholders. *Id.*

The Court then turned to the question whether the other exemption claimed by the defendants, Rule 16b-3(d), was applicable. It was not disputed that the transactions in this case were approved by a vote of the majority of shareholders, in accordance with one of the express conditions set forth in the rule as a qualification

for application of the exemption. The Court noted, however, the rule's application to "grants, awards, and other acquisitions," and stated that the Commission had not made clear what transactions are encompassed by those terms. It apparently accepted the plaintiff's argument that, since "grants" and "awards" imply some form of compensation to the recipient, the rule would exempt only "other acquisitions" that have a compensation-related purpose. Since the reclassification here had no such purpose, the Court held that the reclassification was not exempt under Rule 16b-3(d). 314 F.3d at 124.

The Court "acknowledge[d] that the statement [in the Adopting Release] that 'a transaction need not . . . to be exempt . . . specifically have a compensatory element,' 61 Fed. Reg. at 30379, appears to cut against [the Court's] position." Notwithstanding that acknowledgment and the plain language of the rule - - which does not mention compensation - - the Court held that a compensation-related purpose is required. *Id.*

The Commission was unaware of the *Levy* case before this Court's decision (A:2766-70), but afterward filed an *amicus* brief in support of the defendants' petition for rehearing and rehearing *en banc* (A: 2746-65). However, the Court denied the petition for rehearing, and the Commission was unable to fully present its views.

D. The 2005 Clarifying Amendments

In *Levy I*, this Court noted that "section 16(b) explicitly authorizes the SEC to exempt 'any transaction . . . as not comprehended within the purpose of' the statute." The opinion emphasized that "[t]his section is critical for courts defer to an agency's interpretation of statutes, particularly where the statute provides the agency with authority to make the interpretation." 314 F.3d at 112 (*citing Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984)). This Court continued, stating that "[i]n this case, however, the SEC has not set forth its interpretation clearly so our threshold challenge is to ascertain what in fact was its interpretation." *Id.*

Following *Levy I* the Commission proposed and, in 2005, adopted amendments to Rules 16b-3(d) and 16b-7 "intended to clarify the exemptive scope of these rules" because the *Levy I* decision had "cast[] doubt as to the nature and scope of the transactions exempted from Section 16(b) short-swing profit recovery" by these rules. 2005 Release, 70 Fed. Reg. at 46081.

The 2005 amendments were tailored to undo the uncertainty created by *Levy I.* It is undisputed that the amendments make clear that the acquisitions exempted by Rule 16b-3(d) need not be related to compensation and that Rule 16b-7 applies to reclassifications on the same basis as it exempts mergers and consolidations - - that is,

without the court-imposed conditions concerning proportionate interests and investment risks.

The Commission made the Rule 16b-3(d) amendments available back to the 1996 date that Rule 16b-3(d) was adopted and the Rule 16b-7 amendments available back to the 1991 date that the rule was amended to include "reclassifications" in its title. In so doing, the Commission stated that it has always interpreted Rule 16b-3(d), since its 1996 adoption, as applicable to all acquisitions by officers and directors from issuers that meet the conditions set forth in the rule regardless of whether a compensatory purpose is involved. As to Rule 16b-7, because the amendments clarified the regulatory conditions that applied to that exemption since it was amended in 1991, the Commission made the clarifying amendments available to any transaction after the 1991 amendment that satisfies the regulatory conditions. 2005 Release, 70 Fed. Reg. at 46080.3/

3/ The plaintiff, citing email messages sent to two members of the Commission's staff by an attorney representing the defendants (Br. 11), seems to suggest that the 2005 amendments are the result of a conspiracy between the Commission's staff and counsel for the defendants. It is, however, customary and necessary for the staff of an administrative agency to communicate with counsel representing those affected by its activities. Indeed, following this Court's decision in *Levy I*, counsel for the defendants *and counsel for the plaintiff* met personally with the staff at different times. In addition, the staff received email messages from counsel for the plaintiff.

ARGUMENT

I. PLAINTIFF MISAPPREHENDS THE SCOPE OF THE COMMISSION'S EXEMPTIVE AUTHORITY.

Plaintiff erroneously suggests (Br. 60) that the only transactions that the Commission has authority to exempt from Section 16(b) are those that present *no possibility whatsoever* of insider trading abuse. Congress did not narrowly circumscribe the Commission's authority in that fashion. Congress granted the Commission authority to provide relief from the automatic and rigorous consequences of Section 16(b) where the risk of abuse is diminished, albeit not entirely eliminated.

To remedy speculative abuse, Congress focused in Section 16(b) on insiders' short-swing trading, believing that unfair use of inside information was most likely to occur in that type of trading. This does not mean, however, that Congress believed that short-swing trading was itself wrong, and Congress did not make this trading illegal. Rather, as a means of deterring trading that was abusive, Congress chose to allow recovery of short-swing profits, including profits from trading that was not abusive. The Supreme Court has repeatedly recognized that "'the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great.'" *Kern County Land Co.*, 411 U.S. at 592 (*quoting Reliance Electric*

Co. v. Emerson Electric Co., 404 U.S. 418, 422 (1972)). The Supreme Court has also observed:

> 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.

Reliance Electric Co., 404 U.S. at 422 (*quoting Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970)). As explained by the Commission, a six-month period was chosen because:

> Short swing speculation is deemed to involve incentives and opportunities to profit improperly to a degree not present in connection with long term investment and changes in investment position. The arbitrary period of six months was selected as roughly marking the distinction between short swing speculation and long term investment.

Exemption of Certain Transactions from Section 16(b), *supra*, 17 Fed. Reg. 3177 (April 10, 1952).

This type of remedy was described by its drafters as a "crude rule of thumb." *Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency on S. Res 84, S. Res 56, S. Res. 97*, 73d Cong., 2d Sess. pt. 15, 6557 (1934) (testimony of Thomas Corcoran as spokesman for the drafters of the Exchange Act). It can extract a high price, since it can deprive insiders of profits even in transactions that involve no abuse of inside information. Because of the strict liability nature of Section 16(b)

in imposing liability without fault, "Congress itself limited carefully the liability imposed by §16(b)." *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 252 (1976)*; see also Gollust v. Mendell*, 501 U.S. 115, 122 (1991); *Reliance Electric Co.*, 404 U.S. at 422-23, 425. "Even an insider may trade freely without incurring the statutory liability if, for example, he spaces his transactions at intervals greater than six months. When Congress has so recognized the need to limit carefully the 'arbitrary and sweeping coverage' of §16(b) . . . courts should not be quick to determine that . . . Congress intended the section to cover a particular transaction." *Foremost-McKesson, Inc.*, 423 U.S. at 252; *accord Gollust*, 501 U.S. at 122; *See also* H.R. Rep. 1383, 73d Cong., 2d Sess. 13 (1934).

In adopting Rules 16b-3(d) and 16b-7, as previously noted, the Commission was clear in explaining why the transactions they exempt generally do not lend themselves to the abusive use of inside information with which Section 16(b) is concerned. This is not to say, however, that a transaction in a category exempted by the rules will never in any circumstances involve the possibility of abuse of inside information. But even assuming such abuse could occur in some circumstances, that does not preclude the Commission from adopting a general exemption like Rule 16b-3(d) for an issuer's transactions with its officers or directors. The Commission's exemptive authority is not limited to transactions in which there is never any possibility of insider trading abuse.

Section 16(b) imposes a stringent and relatively arbitrary remedy, which can implicate innocent insiders who simply bought and sold securities within six months. While those effects on innocent insiders are unavoidable when short-swing trading occurs in contexts where unfair use of information is a significant risk, there is no reason to impose such liability in contexts where generally the risk is diminished. As the Ninth Circuit stated in its recent decision upholding Rule 16b-3(d):

> [Plaintiff's] position demands an airtight solution with "no possibility" of abuse. Neither §16(b) nor its judicial gloss suggests, as [plaintiff] does, that the SEC may *only* exempt transactions for which there is zero risk of speculative abuse. Rather, the Supreme Court has indicated that the SEC is free to exempt transactions for which the "*possibility* of abuse" is not "believed to be intolerably great." *Reliance Elec. Co.*, 404 U.S. at 422 (emphasis added). The SEC need not show that the transactions exempted from §16(b) pose absolutely no risk of speculative abuse. *Foremost-McKesson*, 423 U.S. at 244 (finding "unsatisfactory" the argument that the court must reject any reading of a statutory exemption to §16(b) that misses "some possible abuses of inside information"). . . . The relevant question is whether Rule 16b-3(d) exempts transactions for which the risk of speculative abuse is *intolerable* or, more broadly, in the words of the statute, whether the transaction is "not comprehended within the purpose of [§16(b)]."

Dreiling v. American Express Company, 458 F.3d 942, 950 (9th Cir. 2006); *accord At Home Corporation v. Cox Communications*, 446 F.3d 403, 410 (2d Cir. 2006).

II. THE ADOPTION OF AMENDED RULE 16b-3(d) WAS WITHIN THE COMMISSION'S AUTHORITY.

A challenge to the validity of Rule 16b-3(d), similar to the challenge here, was recently rejected by the Ninth Circuit in *Dreiling v. American Express Company*, 458 F.3d at 949-53. In upholding the rule, the court emphasized the Commission's conclusion

that "'where the issuer, rather than the trading markets, is on the other side of an officer or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute.'" 458 F.3d at 948 (*quoting* 1996 Adopting Release, 61 Fed. Reg. at 30377(A:2968)). The court gave "significant weight to the SEC's determination that board-approved insider-issuer transactions were 'not vehicles for the speculative abuse that section 16(b) was designed to prevent,' [1996 Adopting Release], 61 Fed. Reg. at 30377. . ." *Id.* at 949.

For the reasons discussed below, we believe the *Dreiling* decision was correct.

A. The Legislative History Shows that Section 16(b) was Enacted Principally to Prevent the Abuse of Inside Information By Insiders in Their Market Transactions with The Investing Public, Rather than in Their Transactions with Issuers.

Plaintiff takes issue with the Commission's determination that officers' and directors' transactions with the issuer do not present the same opportunities for insider profit on the basis of non-public information as do their transactions in the market (Br. 60-61). The Supreme Court has recognized, however, that Congress was concerned with insiders' use of inside information in their *market* transactions. According to the Court, Congress's concern when it enacted Section 16(b) was that corporate "[i]nsiders could exploit information not generally available to others to secure quick profits," *Kern County Land Co.*, 411 U.S. at 591-92, and "'Congress

recognized that insiders may have access to information about their corporations not available to the rest of the investing public. By trading on this information, these persons could reap profits at the expense of less well informed investors.'" *Gollust v. Mendell*, 501 U.S. 115, 121 (1991) (*quoting Foremost-McKesson, Inc.*, 423 U.S. at 243). Similarly, the *Senate Report on Stock Exchange Practices* discussed the need for what was to become Section 16(b), stating:

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, *to aid them in their market activities*.

S. Rep. No. 1455, 73d Cong. 2d Sess. 55 (1934) (emphasis added). This Senate Report is replete with examples of corporate insiders who, armed with inside information, engaged in unfair trading with market participants. *Id.* at 55-68.4/

When the Senate Committee on Banking and Currency reported on the bill that, in large part, was to become the Securities Exchange Act, it pointed to the *market* activities of corporate insiders as the primary impetus for passage of what is now Section 16, stating that the provision "aims to protect the interests of the public by preventing" insiders "of a corporation, the stock of which is traded on exchanges,

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4/ *See also* 2005 Release, 70 Fed. Reg. at 46083 ("Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public. By trading on this information, those persons could reap profits at the expense of less well informed investors.").

from speculating in the stock on the basis of information not available to others." S. Rep. No. 792, 73rd Cong., 2d Sess. 9 (1934). The Committee Report continued:

> Such a provision will render difficult or impossible the kind of transactions which were frequently described to the committee, *where directors and large stockholders participated in pools trading in the stock of their own companies, with the benefit of advance information* regarding an increase or resumption of dividends in some cases, and the passing of dividends in others.

Id. (emphasis added).

Most importantly, the statutory language itself is consistent with Congress' intent to prevent the speculative abuse that occurs where insiders, with the advantage of possessing inside information, trade with investors who are disadvantaged by the lack of equal information. Section 16(b) states that it was enacted "[f]or the purpose of preventing the *unfair* use of information" (emphasis added). As demonstrated by the legislative history, the unfairness referred to by Congress exists when insiders trade in the market with investors who do not have access to inside information. Such unfairness does not typically exist when the insiders of an issuer trade with the issuer. *See* 1996 Adopting Release, 61 Fed. Reg. at 30377 (A:2968); 2005 Release, 70 Fed. Reg. at 46082.

Plaintiff argues, however, that it was "precisely such transactions [with the issuer] that motivated the adoption of §16(b)." In support of this contention, plaintiff notes that Section 16(b) has often been referred to as the "anti-Wiggin bill" because it was manipulative schemes undertaken by Albert Wiggin, Chairman of

Chase National Bank, that some believe inspired Section 16(b)'s enactment (*citing* S. Thel, *The Genius of Section 16: Regulating the Management of Publicly Held Companies*, 42 Hastings L.J. 391, 428-29 (1991)).

In fact, the Senate Report on Stock Exchange Practices recounts numerous schemes in which Wiggin was involved. *See* S. Rep. No. 73-1455, at 62-63, 95-96, 161-62, 173-84, 186-213, 325-28. However, only one example of Wiggins' activities is recounted in the portion of the report entitled "Market Activities of Directors, Officers, and Principal Stockholders or Corporations," which provided the justification for what is now Section 16(b). That example involves trading in Chase stock in the market. In a section entitled "The pool operations of Albert H. Wiggin in Chase Bank stock," the report recounts that Wiggin "participated in pool operations in Chase Bank stock through the medium of private corporations owned by himself and members of his family" and, during this scheme, "[h]e *also traded actively* in the stock for his own account and on behalf of his corporations." S. Rep. No. 73-1455, at 62-63 (emphasis added). The report continues:

> On July 19, 1929, an account was organized by Dominick & Dominick for the purpose of trading in Chase National Bank stock. . . .
>
> Shermar Corporation furnished 50,000 of the 100,000 shares optioned in this deal. From July 19, 1929, to November 11, 1929, 92,096 shares were acquired by Dominick and Dominick under the options and 80,710 shares were *bought in the open market*, making a total of 172,806 shares purchased for the trading account. Of this total, 115,483 shares *were sold in the market* and 55,227 shares were distributed among the participants upon termination of the account.

The profit derived by the trading account in cash was $1,452.314.68.

S. Rep. No. 73-1455 at 62-63 (emphases added). Through this "pool operation wherein short selling was contemplated and shares of stock in the bank of which he was the chief executive were bought and sold in large volume, . . . Wiggin and his family-owned corporation made a profit of $75,036.10." *Id.* Indeed, the Thel article -- which plaintiff cites in support of the proposition that Section 16(b) was not directed at insiders' market transactions - - cites, on the pages pointed to by plaintiff in his brief, the pages of Senate Report 1455 containing this description of this pool operation run by Wiggin. *See* S. Thel, *The Genius of Section 16*, at 428-29 n.114 (*citing* S. Rep. 73-1455, at 62-63).

In addition, plaintiff cites (Br. 61) a book written by Ferdinand Pecora, who oversaw the Senate investigation of stock practices, and suggests that Pecora believed that Section 16(b) was directed at trades between the insiders and the issuer. Pecora, however, provided testimony to the Senate Banking Committee in which he described the purpose of Section 16(b). Pecora testified that the concern underlying Section 16(b) was that a corporate insider "could acquire confidential information which he might use for his own enrichment by trading *in the open market,* against the interests of the general body of the stockholders. That is the main purpose sought to be served." *Hearings on S. Res. 84 and S. Res. 56 and S. Res. 97, supra*, pt. 16, at 7741-43 (emphasis added).

Plaintiff mistakenly relies on case law that preceded *Chevron* deference to administrative agencies (Br. 39-40; Reply Br. 25).5/ Plaintiff cites *Perlman v. Timberlake*, 172 F. Supp. 246, 256 (S.D.N.Y. 1959) and *dictum* in *Greene v. Dietz*, 247 F.2d 689 (2d Cir. 1957), where former Rule X-16b-3 was found invalid or questioned.6/ The *Greene* and *Perlman* decisions concerning former Rule X-16b-3's validity were based on the incorrect belief that an exemptive rule promulgated by the Commission that might allow any possibility of insider trading abuse was beyond the Commission's authority to adopt. *See, e.g.,Greene v. Dietz*, 247 F.2d at 693 (stating that "we can still envision insider trading abuses made possible by the broad exemptions of employee stock purchase options granted by Rule X-16B-3"). This is no longer the view of the Second Circuit, which has recently recognized that Section 16(b) seeks to take profits from a class of transactions where the possibility of abuse of inside information does not merely exist, but where the possibility is "intolerably great." *See Bruh v. Bessemer Venture Partners III L.P.*, 464 F.3d 202, 206 (2d Cir. 2006); *At Home Corp. v. Cox Communications, Inc.*, 446 F.3d 403, 409 (2d Cir. 2006).

5/ *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

6/ *Greene* and *Perlman* involved the treatment of options under an old rule that is no longer in force.

B. Substantial Safeguards Exist Under the Rule to Prevent Abuse of Inside Information.

1. The risk that Rule 16b-3(d) transactions will be vehicles for speculative abuse by insiders is limited by the gatekeeping conditions the rule imposes on the transactions. Acquisitions exempted by Rule 16b-3(d) must be approved either by the issuer's board (or committee of two or more non-employee directors) or by the shareholders. The rule requires that each transaction be approved to assure that the board focuses on each particular transaction, and is accountable for authorizing each one. These approval conditions ensure that appropriate company gate-keeping procedures are in place to monitor acquisitions by officers and directors and to ensure acknowledgment and accountability on the part of the company. 1995 Proposing Release, 60 Fed. Reg. at 53835 (A:2960). Board or shareholder approval will remove the timing of the acquisition from the control of any one insider and also tends to ensure that the acquisition is for a legitimate corporate purpose. *See Gryl v. Shire Pharmaceuticals Group PLC*, 298 F.3d 136, 145-46 (2d Cir. 2002).

2. Plaintiff derides (Br. 62-63) the Commission's reliance on state law remedies in adopting Rule 16b-3(d). *See* 60 Fed. Reg. at 53833 (A:2958). Plaintiff complains that Congress found these state law remedies to be inadequate to prevent insider trading (Br. 62). In upholding the validity of Rule 16b-3(d), however, the Ninth Circuit recognized the significance of state law remedies, stating:

> The SEC did not justify Rule 16b-3(d) *solely* on the grounds that state laws could replace §16(b) as the remedy for short-swing insider trading. Rather, the transactions covered by Rule 16b-3(d) were ones the SEC determined did not give rise to an intolerable risk of speculative abuse. *The SEC also noted that state laws on fiduciary duty and self-dealing might help remedy any residual speculative abuse that did occur. See* 61 Fed. Reg. at 30,381. *The SEC should not be penalized for explaining multiple reasons why the rule makes sense.*

Dreiling, 458 F.3d at 952 (emphasis added). It was reasonable, as the Ninth Circuit recognized, for the Commission to take into account the protections afforded by state fiduciary law.7/

III. THE ADOPTION OF AMENDED RULE 16b-7 WAS WITHIN THE COMMISSION'S AUTHORITY.

The plaintiff argues that the exemption of reclassifications in Rule 16b-7 is beyond the Commission's exemptive authority (Br. 63-64). In a recent decision, the Second Circuit disagreed and held that Rule 16b-7 "falls safely within the Commission's delegated authority" because, among other things, it cannot be doubted "'that like treatment of all stockholders will in most cases remove the possibility of abuse.'" *Bruh v. Bessemer Venture Partners III L.P.*, 464 F.3d 202, 214 (2d

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7/ The Commission further noted in the 1996 Adopting Release that "[t]here are also potential liability considerations under Rule 10b-5." 61 Fed. Reg. at 30377 n.17 (A:3007). While this would not be so where an insider deals with a fully informed board which had not been deceived, or a fully informed shareholder electorate, it would apply to a securities transaction involving deception of the board or shareholders in obtaining the requisite approval. *See SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848, 850 (2d Cir. 1968) (finding a violation of Rule 10b-5 where insiders withheld material information from the issuer's stock options committee).

Cir. 2006) (*quoting Roberts v. Eaton*, 212 F.2d 82, 84 (2d Cir. 1954)).

In adopting the 2005 amendments to Rule 16b-7, the Commission stated that "Rule 16b-7 is based on the premise that the exempted transactions are of relatively minor importance to the shareholders of a particular company and *do not present significant opportunities to insiders to profit by advance information* concerning the transaction." 2005 Release, 70 Fed. Reg. at 46085 (emphasis added). "Indeed," the Commission continued, "by satisfying either of the rule's 85% ownership tests, an exempted transaction does not significantly alter the economic investment held by the insider before the transaction." *Id.* Thus, the Commission focused on exempting transactions where profit recovery would not serve the purpose of the statute. The Commission noted when it adopted the 2005 amendments that, "[a]lthough the rule as amended in 1991 did not contain specific standards for exempting reclassifications, the staff applied to reclassifications the same standards as for mergers and consolidations." The Commission explained:

> In relevant respects a reclassification is little different from a merger exempted by Rule 16b-7. In a merger exempted by the rule, the transaction satisfies either 85% ownership standard, so that the merger effects no major change in the issuer's business or assets. *Similarly, in a reclassification the issuer owns all assets involved in the transaction and remains the same, with no change in its business or assets.*

2005 Release, 70 Fed. Reg. at 46084 (emphasis added). In essence, in mergers and consolidations meeting the 85% common ownership requirement of Rule 16b-7, the insider acquires what he or she essentially already owned such that the possibility of

the abuse of inside information derived from an unfair informational advantage either is non-existent or not "intolerably great." This is true with even greater force in the case of reclassifications, where the ownership is 100%.

It is also generally true that reclassifications resulting in the exchange of an entire class of stock - - such as the reclassification in this case, as part of the preparation for an initial public offering - - take place for a legitimate corporate purpose and thus do not involve the abuse of inside information. *See Bruh v. Bessemer Venture Partners III L.P.*, 464 F.3d at 214; *Cf. Gryl v. Shire Pharmaceuticals Group*, 298 F.3d at 145-46.

IV. THE 2005 AMENDMENTS ARE PERMISSIBLY APPLICABLE TO PRIOR TRANSACTIONS.

The plaintiff argues that the 2005 amendments to Rules 16b-3(d) and 16b-7 cannot be applied here because that would be an impermissible retroactive application. While an agency may not promulgate "retroactive" rules absent express congressional authority, *see Bowen v. Georgetown University Hospital*, 488 U.S. 204, 208 (1988), "'[c]oncerns about retroactive application are not implicated when an amendment that takes effect after the initiation of a lawsuit is deemed to clarify relevant law rather than effect a substantive change in the law.'" *King v. American Airlines, Inc.*, 284 F.3d 352, 358 n.3 (2d Cir. 2002) (*quoting Piamba Cortes v. American Airlines, Inc.*, 177 F.3d 1272, 1283 (11th Cir. 1999)). "A rule simply clarifying an

unsettled or confusing area of the law . . . does not change the law, but restates what the law *according to the agency* is and has always been: 'It is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand.'" *Pope v. Shalala*, 998 F.2d 473, 483 (7th Cir. 1993)(emphasis added) (*quoting Manhattan General Equip. Co. v. Commissioner*, 297 U.S. 129, 135 (1936), *overruled on other grounds, Johnson v. Apfel*, 189 F.3d 561 (7th Cir. 1999)); *accord Appalachian States Low-Level Radioactive Waste Comm. v. O'Leary*, 93 F.3d 103, 113 (3d Cir. 1996). Clarifying rules are necessary "'to clarify existing law, to correct a misinterpretation, or to overrule wrongly decided cases.'" *Piamba Cortes*, 177 F.3d at 1283 (*quoting United States v. Sepulveda*, 115 F.3d 882, 885 n.5 (11th Cir. 1997)).8/

8/ Plaintiff's brief (Br. 31-33) confuses two different modes of analysis: (a) the analysis used in determining whether a rule amendment is clarifying for purposes of retroactivity and (b) the analysis used to distinguish legislative rules from interpretive rules for the purpose of deciding whether notice and comment rulemaking is required under the APA. For example, plaintiff cites *Chao v. Rothermel*, 327 F.3d 223, 227 (3d Cir. 2003), where the issue was whether notice and comment rulemaking was required, for the proposition that a rule is not interpretive when an agency amends the language of the rule. Since the rule is not interpretive, under plaintiff's analysis, it is legislative and, therefore, may only be applied prospectively. All that *Choa* held, however, is that notice and comment rulemaking is necessary to change the language of a rule. Indeed, the Commission used notice and comment rulemaking when it amended Rules 16b-3(d) and 16b-7 in 2005. This, however, does not determine whether the amendments are merely clarifying and, therefore, permissibly retroactive. Amendments that change the language of a regulation may be merely clarifying and, therefore, permissibly retroactive. *See Piamba Cortes*, 177 F.3d at 1283; *First National Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472, 479 (7th Cir. 1999).

With respect to Rule 16b-7, the 2005 amendment merely clarified the meaning of the rule as it existed, and thus is not impermissibly retroactive. While the plaintiff contends that the amendment "overturned" this Court's opinion in *Levy I*, that decision was never a conclusive determination of what Rule 16b-7 required. In *Levy I* this Court stated that it was articulating standards under the rule only because, in its view, the Commission had not made clear what standards were to be applied in exempting reclassifications. It stated that "[i]n this case . . . the SEC has not set forth its interpretation clearly so our threshold challenge is to ascertain what in fact was its interpretation." 314 F.3d at 112. *Levy I* went on to state that "[i]n the absence of specific SEC guidance about which reclassifications are exempt from section 16(b) under Rule 16b-7," it would reach its own conclusion as to standards the Commission would apply. *Id.* at 114. This Court likewise found Rule 16b-3(d) unclear, holding that "[t]he SEC's adopting release strongly suggest[s] that the SEC intended, in Rule 16b-3(d), to exempt grants, awards, and other acquisitions with some compensatory nexus. . ." *Id.* at 124.9/ This Court did not suggest that it would

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9/ *Levy I* reasoned, and plaintiff argues (Br. 37-38), that under rules of statutory construction, Rule 16b-3(d) should be read to require that a transaction have a compensatory purpose in order to be exempted. The theory is that under the principle of *ejusdem generis* "'other acquisitions' denotes a form of compensation consistent with the use of the words 'grant' and 'award.' . . ." 314 F.3d at 124. However, "[i]t is 'axiomatic that the [agency's] interpretation need not be the best or most natural one by grammatical or other standards. . . Rather, the [agency's] view need be only reasonable to warrant deference." *Bruh v. Bessemer*

or could undertake this analysis if the Commission itself clarified the rule.

The situation is very different now. The adopting release for the 2005 amendments repeatedly states that the Commission was only supplying a clarifying interpretation of the existing rules. *See* 2005 Release, 70 Fed. Reg. 46080. The Commission noted that after *Levy I*, "[t]he resulting uncertainty regarding the exemptive scope of these rules has made it difficult for issuers and insiders to plan legitimate transactions . . . . With the clarifying amendments to Rules 16b-3 and 16b-7 that we adopt today, we resolve any doubt as to the meaning and interpretation of these rules by reaffirming the views we have consistently expressed previously regarding their appropriate construction." 2005 Release, 70 Fed. Reg. at 46081. The Commission's view as to what it believed it was doing by adopting the amendments is highly significant. *See Taylor v. Vermont Department of Education*, 313 F.3d 768, 780 n.8 (2d Cir 2002); *First National Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472, 478 (7th Cir. 1999). The Commission view was supported by the weight of comments on the amendments when they were proposed. "Most commenters stated that the

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Venture Partners III L.P., 464 F.3d at 207 (*quoting Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 702 (1991)) (brackets in original). Furthermore, the *Levy I* construction runs counter to the Commission statement that "unlike the current rule, a transaction need not be pursuant to an employee benefit plan or any compensatory program to be exempt, nor need it specifically have a compensatory purpose." Adopting Release, 61 Fed. Reg. at 30378-79 (A:2971).

proposals would accomplish the goal of clarifying the exemptive scope of Rule 16b-3 as the Commission originally intended the rule to apply" and "would accomplish the goal of clarifying the exemptive scope of Rule 16b-7 . . . consistent with [the Commission's] previous statements regarding the scope of this rule." 2005 Release, 70 Fed. Reg. at 46082, 46085. Resolving doubt and confusion as to what existing law provides is the role of a clarifying amendment. 10/

"In the administrative context, a rule is [impermissibly] retroactive if it 'takes away or impairs vested rights acquired under existing law, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations already past.'" *National Mining Association v. Department of Labor*, 292 F.3d 849, 859 (D.C. Cir. 2002) (*quoting National Mining Association v. Department of*

10/ Citing a 1987 report, plaintiff suggests (Br. 51) that the American Bar Association did not believe that Rule 16b-7 exempted reclassifications. The ABA, however, sent a letter to the Commission commenting on the rule amendments when they were proposed in 2004. The summary of the comments received on the proposed amendments makes reference to the ABA's letter in noting that, with the exception of Section 16(b) counsel representing plaintiffs, "there was a general consensus that this rulemaking is necessary to eliminate the uncertainty generated by the Third Circuit's construction of the rules in *Levy v. Sterling Holding Company* . . . that has made it difficult for insiders wishing to 'engage in legitimate transactions in reliance on prior Commission interpretations of these two rules.'" *Comment Summary - - Release 34-49895, Ownership Reports and Trading by Officers, Directors and Principal Security Holders Proposal*, available (together with the ABA comment letter) at http://www.sec.gov/rules/extra/s72704comsum.htm (*quoting Letter of the American Bar Association, Section of Business Law*, August 16, 2004 (emphasis added)).

Interior, 177 F.3d 1, 8 (D.C. Cir. 1999)). The 2005 amendments did nothing like this. They "did not alter existing rights or obligations; [they] merely clarified what those existing rights and obligations had always been" and, "[a]s a result . . . had no . . . retroactive impact." *Appalachian States Low - Level Radioactive Waste Comm.*, 93 F.3d at 113.

Indeed, the Second Circuit found it unnecessary to reach the question of whether the 2005 amendments to Rule 16b-7 were permissibly retroactive because:

> We think the question of whether the current Rule 16b-7 would have retroactive effect if applied to the transactions at issue here turns primarily upon the answer we have given above, namely, that even applying the prior Rule 16b-7, according to the Commission's reasonable interpretation, the transaction is exempt. Needless to say, where applying the old rule produces the same result as would the new rule, there is no impermissible retroactive effect.

Bruh, 464 F.3d. at 213; *see also Dreiling*, 458 F.3d at 953 (finding that the Commission has, since the adoption of Rule 16b-3(d), consistently interpreted the rule as not requiring a compensatory related purpose).

This Court's prior decision in *Levy I* does not render the amendments impermissibly retroactive. *See United States v. Marmolejos*, 140 F.3d 488, 493 (3d Cir. 1998)(overturning a previous final determination of a defendant's sentence by a prior panel because of a conflicting intervening interpretation of the sentencing guidelines); *see also Pope*, 998 F.2d at 486 ("[W]hen our interpretation [of a regulation] is shown to

be inconsistent with that of the agency's [subsequent clarifying amendment], we must give way to the agency.").

V. THE 2005 AMENDMENTS ARE ENTITLED TO CONTROLLING DEFERENCE.

The Commission's determination that the rules exempt transactions that are "not comprehended within the purpose" of Section 16(b), and may thus be exempted, is entitled to *Chevron* deference, while its interpretations of the rules themselves are entitled to *Seminole Rock* deference.

A. The Commission's Interpretation of Section 16(b) Is Entitled to *Chevron* Deference.

The Commission's interpretation of its rulemaking authority granted by Section 16(b) is entitled to controlling deference, so long as that interpretation is reasonable. As the Supreme Court recently summarized:

> In *Chevron* [*U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)], this Court held that ambiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion. Filling these gaps, the Court explained, involves difficult policy choices that agencies are better equipped to make than courts. 467 U.S. at 865-866 . . . If a statute is ambiguous, and if the implementing agency's construction is reasonable, *Chevron* requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation. *Id.* at 843-844, and n. 11.

National Cable & Telecommunications Assoc., v. Brand X Internet Services, 545 U.S. 967, 980 (2005). In a recent decision upholding Commission authority to adopt Rule 16b-7,

the Second Circuit noted that "Congress explicitly delegated to the Commission the policymaking authority to exempt certain transactions 'as not comprehended within the purpose of this subsection,' and took the further step of admonishing the courts that the statute 'shall not be construed' otherwise." *Bruh*, 464 F.3d at 208 (*quoting* Section 16(b)). As such, the Commission's exemptive rules are, as the court found in *Bruh*, entitled to a "strong presumption of validity." *Id.* at 214.

The Commission's rationales for exempting transactions between an issuer and its officers and directors and for exempting reclassifications reflect reasonable interpretations of the statute. These interpretations, which are the product of notice and comment rulemaking, are entitled to *Chevron* deference.

B. The Commission's Interpretations of Rules 16b-3(d) and 16b-7 Are Entitled to *Seminole Rock* Deference.

The Commission's interpretation of Rule 16b-3(d) as exempting acquisitions by insiders from the issuer, whether or not there is a compensatory purpose, and the Commission's interpretation of Rule 16b-7 as exempting reclassifications are entitled to *Seminole Rock* deference, another type of controlling deference, because the Commission is interpreting its own rules. "'Because applying an agency's regulation to complex or changing circumstances calls upon the agency's unique expertise and policymaking prerogatives, we presume that the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers.'" *Bruh*,

464 F.3d at 208 (*quoting Martin v. Occupational Safety & Health Review Comm'n*, 499 U.S. 144, 151 (1991) in finding Rule 16b-7 valid). Thus, the Commission's interpretation of these rules "becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Bowles v. Seminole Rock & Sand Company*, 325 U.S. 410, 413-14 (1945); *accord Auer v. Robbins*, 519 U.S. 452, 461 (1997) (stating that an agency's interpretation of its own regulation contained in an *amicus* brief is controlling unless plainly erroneous or inconsistent with the regulation). The Commission's interpretations of Rules16b-3 and 16b-7 are consistent with the language and underlying purposes of the rules and are therefore reasonable and entitled to controlling deference.

C. Deference is Not Precluded by *Levy I*.

The plaintiff erroneously claims that deference principles are inapplicable where, as here, deference would supersede an interpretation previously made by this Court in *Levy I*. But the Supreme Court has held that "[o]nly a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction." *Brand X Internet Services*, 545 U.S. at 982-83. Thus, "[w]here a prior panel of [the Third Circuit] has interpreted an ambiguous statute in one way, and the responsible administrative agency later resolves the ambiguity another way, [the Third Circuit] is not bound to close its eyes to the new source of enlightenment." *United*

States v. Marmolejos, 140 F.3d at 493 (overturning the a previous final determination of a defendant's sentence by a prior panel because of a conflicting intervening interpretation of the sentencing guidelines).11/ Indeed, the Supreme Court has held that an agency's later interpretation of an ambiguous statutory term "trumps" a prior interpretation by the court of appeals. *Brand X Internet Services*, 545 U.S. at 982.

11/ Plaintiff states (Reply Br. 8) that *United States v. Marmolejos* was distinguished by *United States v. Roberson*, 194 F.3d 408, 417 (3d Cir. 1999) because "an agency interpretation overruling a prior construction of a rule by this Court effects a substantive change in the law rather than a clarification and, accordingly, could only be applied prospectively." To the contrary, this Court in *Roberson* distinguished *Marmolejos* because, unlike the provision being construed in *Marmolejos*, the provision at issue in *Roberson* was not ambiguous. *Roberson*, 194 F.3d at 417.

CONCLUSION

For the foregoing reasons, the Commission urges this Court to hold that (1) Rules 16b-3(d) and 16b-7 are within the Commission's exemptive authority and (2) the 2005 amendments to the rules are permissibly applicable to transactions predating the adoption of the amendments and are applicable to the reclassification at issue here.

Respectfully submitted,

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July 2007

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 07-1849

MARK LEVY,

Plaintiff-Appellant,

v.

STERLING HOLDING COMPANY, LLC., NATIONAL SEMICONDUCTOR CORPORATION, and FAIRCHILD SEMICONDUCTOR INTERNATIONAL, INC.,

Defendants-Appellees.

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32(a)(1)(C)

This will certify that the foregoing BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, IN SUPPORT OF THE POSITION OF THE APPELLEES is printed in 14 point type and is 8910 words in length consistent with the MOTION OF THE SECURITIES AND EXCHANGE COMMISSION TO EXCEED THE WORD LIMIT, excluding the cover page, tables of authorities and contents, and the attached certificates.

/s/ Allan A. Capute

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Defendants-Appellees.

CERTIFICATION OF BAR MEMBERSHIP

Amicus curiae, the United States Securities and Exchange Commission, is an independent regulatory agency of the Government of the United States. As such, its counsel, Jacob H. Stillman and Allan A. Capute, are exempt from the bar membership requirements of this Court.

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CERTIFICATE OF VIRUS CHECK

This will certify that the foregoing BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, IN SUPPORT OF THE POSITION OF THE APPELLEES, and the accompanying MOTION OF THE SECURITIES AND EXCHANGE COMMISSION TO EXCEED THE WORD LIMIT, in PDF format have been checked using McAfee VirusScan version 8.5i updated July 30, 2007.

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CERTIFICATE OF IDENTICAL COMPLIANCE OF BRIEFS

This will certify that the text of the paper copy of the foregoing BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, IN SUPPORT OF THE POSITION OF THE APPELLEES is identical to the electronic copy filed with the Clerk of the Court.

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Defendants-Appellees.

CERTIFICATE OF SERVICE

I, Allan A. Capute, am a member of the bars of Maryland and the District of Columbia, and I hereby certify that on 31st day of July, 2007, I caused to be served two copies of the BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, *AMICUS CURIAE*, IN SUPPORT OF THE POSITION OF THE APPELLEES on counsel for the parties of record at the addresses below, by Federal Express.

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