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CASE NO. 08-1037

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US Court of Appeals
4th Circuit

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
Plaintiffs-Appellees,

v.

PIRATE INVESTOR LLC AND FRANK PORTER STANSBERRY,
Defendants.

APPEAL FROM A FINAL JUDGMENT
OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

REPLY BRIEF OF APPELLANTS-DEFENDANTS PIRATE INVESTOR LLC AND FRANK PORTER STANSBERRY FOR REVERSAL OF THE DISTRICT COURT'S DECISION

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I. Section 10(b)'s jurisdictional requirement of statements "in connection with the purchase or sale of any security" is lacking in this case.

Remedial statutes, the SEC argues, are broad in scope, but the problem with the SEC's approach in this case is that it sees itself as untethered by any statutory constraints at all. For example, when this action began, the SEC initially proposed an "inside information" standard that would set this case apart from other pure speech about stocks that the government promised to leave alone. According to the SEC, "[a] Money magazine article about '10 Stocks to Buy Tomorrow'" would be protected because it was "based just on analysis of the companies," whereas the Report was singled out for an enforcement action because its publishers "said they had inside information about a specific deal." JA4861.

With the "inside information" standard now discarded – the district court explicitly rejected it, JA158 – the SEC floats a new standard. The Report is covered by § 10(b) because it was "virtually certain" or "almost certain" that readers would buy USEC shares after purchasing the Report. Op.Br.2, 5, 18, 34-35. If the test is "virtual certainty," then the Money magazine article envisioned by the SEC on "10 Stocks to Buy Tomorrow" would also surely meet the test as regulated speech – like the Report, the article tells a reader precisely which stocks to buy and when to buy them.

However, the SEC's "virtual certainty" standard for regulating impersonal investment advice has effectively been rejected – by Lowe v. SEC, 472 U.S. 181 (1985). The Supreme Court plainly understood that subscribers would purchase or sell securities based on the advice in Lowe, since such advice consisted of specific "buy" and "sell" recommendations. But the Court still read all of this detailed "investment advice" out of "Investment Advisers Act" because the advice was not provided in the context of a fiduciary relationship and regulating it would thus create constitutional concerns.

The publication of impersonal investment advice that readers could be expected to follow in some shape or form was protected by Lowe – and an entire industry has grown up around it. The incongruity of protecting specific investment advice ("virtually certain" to be acted on by readers) from the '40 Act while simultaneously subjecting it to the '34 Act (because it is "virtually certain" to be acted on by readers) is self-evident. Whether the Report cost $1,000 or $100 or was given away for free as part of a promotion to attract new subscribers is immaterial because the subsequent trading by readers is itself immaterial. A reader's trading does not trigger the '40 Act, nor should it trigger the '34 Act.

The SEC's ever-shifting rationales to explain why pure speech should be covered by § 10(b) demonstrate the danger of turning the securities laws loose beyond their jurisdictional mandate. There is no standard under § 10(b) more predictable, more pragmatic, more true to the precedent, and more constitutionally-appropriate than limiting the statute's reach to fiduciaries or to persons who buy and sell stocks. If the SEC believes that particular investment advice is unprotected under Lowe's reading of the bona fide publisher's exemption, then the '40 Act, the statute written for investment advice, is the proper place for the government to look, not to § 10(b), the statute covering securities transactions.

A. The SEC's "virtual certainty" test contains no cogent, limiting principle and does not comport with the holding in Lowe.

In rejecting the SEC's theory of liability in Dirks v. SEC, 463 U.S. 646, 664 (1983), the Supreme Court wrote, "[I]t is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed" by the SEC's rules. The SEC's proposed "virtual certainty" provides no such guidance. It misunderstands the relationship between readers and publishers, invites substantial constitutional concerns, contains no practical limitations, is found nowhere in § 10(b) case law, and conflicts with the controlling principles in Lowe.

The publications in Lowe offered "specific recommendations for buying, selling, or holding stocks" and included a "telephone hotline" with "current information." 472 U.S. at 185 n.7. Like the publishers in Lowe, the defendants expect their subscribers – or anyone who happens to come across one of their recommendations – to make use of their advice. The Author's recommendations are also often picked up by other media for the benefit (and potential trading decisions) of their subscribers, as was recently the case with Barron's positive coverage of his predictions regarding the Fannie Mae and Freddie Mac meltdowns. Alan Abelson, Au Revoir or Goodbye?, BARRON'S, July 14, 2008, at 5.

To predicate § 10(b) jurisdiction on the "virtual certainty" that a reader might purchase stocks based on the content of a publication is incompatible with Lowe and would strip away protections it established for impersonal investment advice. The protections in Lowe did not change depending on the cost of the publication, the number of stocks recommended, or the byline under which the advice was published. Whether any of these factors made it more or less likely that a reader would trade on the recommendations was irrelevant. Obviously, trades took place. It may be "virtually certain" that a reader may seek out a new therapy enthusiastically praised in a health column, but that does not give the FDA jurisdiction over the columnist as if she were a drug manufacturer, nor a state medical board as if she were a prescribing physician.

The SEC states that addressing the implications for the publishing business at large of its theory in this case can be deferred until it sues a "bona fide" publication and claims that there is a "huge difference" between the Report and other "reporting on or opining about financial matters." Op.Br.4-5. The SEC has at various times tried to explain that "huge difference" in terms of whether the publication concerned "inside information" about corporate deals or announcements, whether it had a "purpose" other than giving investment advice, and how much it costs to subscribe. Here, the SEC asserts that the "virtual certainty" test is met simply because readers paid $1,000 for the Report.

But there is no practical (or constitutional) way to classify speakers for purposes of § 10(b) based on the cost of the publication and what the SEC believes to be the likely use of the speech. A publisher's profit motive on the sale of information is constitutionally-protected. Harte-Hanks Commc'ns v. Connaughton, 491 U.S. 657, 667 (1989). The "virtual certainty" test would also inevitably entangle the government in improper content discrimination. The SEC insisted at trial, for example, that investment columns in amicus curiae The Baltimore Sun are different from the advice in the Report because "you don't buy [the Sun] to read the investment column ... that's not why it's distributed ... that is not why it is published." JA1447. This awkward effort to justify why one publication is legitimate and one is not places the SEC dangerously close to – if not squarely in – the regulatory role the Supreme Court rejected for it in Lowe.

The two cases the SEC cites in support of the "virtual certainty" argument were decided under the Commodity Exchange Act ("CEA"). Op.Br.35. Both involve advertisements for computerized trading software that the Second Circuit held was not even "speech" under the First Amendment. CFTC v. Vartuli, 228 F.3d 94, 111 (2d Cir. 2000). Using software for an "automatic trading system" on a computer, id. at 112, is simply not analogous to evaluating investment advice in a publication – and then taking the extra step of contacting a broker to purchase a stock.[1] As noted in a successful challenge to CFTC registration requirements:

> The Wall Street Journal, Barrons, and Money Magazine ... all have specific columns providing investment advice and, unless they are wasting their time, hope that their readers will use it. To refuse to see the difference between the broker who gives advice to her client and the publisher of a newsletter is to ignore the cases ... that discuss the distinction between a professional's advice to a client and a writer's advice to whoever will read her and use it.

Taucher v. Rainer, 237 F. Supp. 2d 7, 14 (D.D.C. 2002).

The assurance from the SEC that § 10(b) does not "reach 'pure speech' disconnected from the harm to investors or the markets," Op.Br.48, equally fails to provide a cogent limitation on its powers. Like the "virtual certainty" test, making the reach of § 10(b) coextensive with any "harm" to investors caused by speech – a standard which of course would apply to private actions by investors themselves – would, needless to say, "not be easily contained." Santa Fe Indus. v. Green, 430 U.S. 462, 478 (1977). Such an elastic concept has no place among Supreme Court precedent repeatedly blocking SEC efforts to extend the scope of § 10(b) for other

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[1] The attempt to draw an analogy between the CEA and § 10(b) also fails because the defendants in the two cases the SEC cites met the definition of "commodities trading advisers" under the CEA. Vartuli, 228 F.3d at 104; R & W Tech. Servs. v. CFTC, 205 F.3d 165, 176 (5th Cir 2000). The appropriate analogy is thus between the CEA and the Investment Advisers Act – the statute the SEC did not use here.

altruistic reasons. Br.27-30. To maintain the jurisdictional constraints Congress created, the "guiding principle," Dirks, 463 U.S. at 664, for the "in connection with" requirement is a defendant's trading activity or fiduciary breach.

B. Misrepresentation cases, as well as omission cases, must satisfy O'Hagan's requirement that fraud "coincide" with stock transactions.

The SEC disputes the applicability of the Supreme Court test requiring a stock trade to "coincide" with or "consummate" an alleged fraud in order to satisfy the "in connection with" element. It argues that the test does not apply to fraud by misrepresentation cases and that the defendants have misconstrued the test. Neither argument has merit.

In SEC v. Zandford, 535 U.S. 813, 820-21 (2002), the Supreme Court affirmed that to satisfy the "in connection with" element of § 10(b) there must be fraudulent conduct that "coincide[s] with" and "require[s] the sale of securities." The Supreme Court offered this sweeping summary of its "in connection with" cases: "As in Bankers Life, Wharf, and O'Hagan, the SEC complaint [in Zandford] describes a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide. Those breaches were therefore 'in connection with' securities sales ... ." Id. at 825.

Liability under § 10(b) can be established over "misstatements" as well as by "omissions by one who has a duty to disclose." Stoneridge Inv. Partners v. Scientific-Atlanta, 128 S. Ct. 761, 769 (2008). United States v. O'Hagan, 521 U.S.

642, 656 (1997) was a duty to disclose case. Wharf and Bankers Life were misrepresentation cases. See The Wharf (Holdings) Ltd. v. United Int'l Holdings, 532 U.S. 588, 591, 594, 596 (2001) (oral promises relating to the sale of an option were "misrepresentation[s]" because there was no intent to honor the assurances); Sup't of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 8 n.1 (1971) (defrauded party's board was deceived into authorizing a sale of Treasury bonds by the "misrepresentation that the proceeds would be exchanged for a certificate of deposit of equal value").

It is clear from Zandford that the assertion that fraud under § 10(b) must "coincide" with securities transactions applies to "in connection with" jurisprudence going back to Bankers Life. It is also clear that this line of precedent includes both affirmative misrepresentation cases and failure to disclose cases. The SEC's effort to skirt around the "coinciding" requirement on the grounds that it only applies to failure to disclose cases is directly rebutted by the Supreme Court.

Neither the Supreme Court, nor the defendants, treats the "coinciding" test as if it literally were a temporal requirement that a misrepresentation or failure to disclose must actually occur at the same precise moment as the purchase or sale of a security. In some instances, such as in O'Hagan, that may be true. But in others, not. For example, in Bankers Life, the misrepresentation to the insurance company's board took place before it sold the Treasury bonds, but the fraudulent conduct "coincided" with, or depended upon, the securities transaction because, without the transaction, there would have been no fraud. Similarly, in SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968), the company's press release was obviously published prior to any securities trading by investors based on it, but the statements and the trades "coincided" for purposes of § 10(b) because the trading was needed to complete the fraudulent conduct.[2]

Thus, the fact that readers bought the stock after publication of the Report is not what disconnects the alleged fraud from "the purchase or sale of any security." Rather, it is that the alleged fraud was consummated and concluded when the Report was sold and the reader paid $1,000. If there was a fraudulent scheme, no subsequent securities transactions were necessary to it, as neither the Publisher nor the Author derived any benefit from such trading. Indeed, the defendants would have committed fraud if not a single purchaser of the Report bought USEC shares, or if the Report named a fictitious company with a fictitious ticker symbol, because they still would have "defrauded" readers of the cost of the publication.

[2] A case the SEC cites, Op.Br.33, shows that the "coinciding" test is not a temporal test. In SEC v. Merrill Scott & Assoc., 505 F. Supp. 2d 1193, 1203-04 (D. Utah 2007), a money manager's "misrepresentations" to his investors that their assets would be safe if they invested in a Ponzi scheme and that their money would be managed as promised for a specific rate of return occurred well before the broker began siphoning money from the investors' accounts.

Addressing the embezzlement hypothetical from O'Hagan, the SEC compares the use of the funds from the theft with the use of the information in the Report. Op.Br.34-35. But the proper analogy is between the embezzler's use of the stolen cash and the defendants' use of the allegedly defrauded proceeds from the sale of the Report. In both cases, to quote the SEC, there is no "obvious immediate relationship" between the wrongdoer's use of the "money obtained" by the fraud and a later securities transaction – and thus the "in connection with" requirement is not met.

Moreover, had any readers sued the defendants for common-law fraud (an avenue open to them though no such actions were brought), they would have had standing regardless of whether they bought USEC stock. And they would have been limited in their recovery of damages to the price of the Report – $1,000. See Hinkle v. Rockville Motor Co., 278 A.2d 42, 44 (Md. 1971) (measure of damages is out-of-pocket loss, calculated as value of object as represented less actual value at time of sale, where other damages too speculative); Robertson v. Parks, 24 A. 411 (Md. 1892) (refusing to award damages for capital losses despite stock purchase induced by promise of 20 percent returns). The limitation of damages to the cost of the Report in a hypothetical common-law fraud action reinforces that the alleged fraud was successfully achieved when the purchase of the publication was complete and thus did not "coincide with" or "require," Zandford, 535 U.S. at

820-21, the purchase or sale of any security.

C. The reasonableness standard of Texas Gulf is tied to fiduciary duty.

Texas Gulf establishes a reasonableness standard: the statements by the issuer in that case were covered by § 10(b) because they "would cause reasonable investors to rely thereon," and "so relying, cause them to purchase or sell a corporation's securities." 401 F.2d at 860. The SEC stipulated that the defendants did not trade USEC shares, and nowhere does it argue that the Publisher and Author have fiduciary or special duties to their readers or the public. The SEC nonetheless defends the district court's extension of the Texas Gulf rule to this case, claiming that the defendants "merely identify a number of Section 10(b) cases in which the defendants were traders or fiduciaries and then erroneously suggest" that Texas Gulf is therefore limited to such persons. The defendants did not "merely identify" a few random § 10(b) cases – they addressed the very cases on which the district court relied to extend the Texas Gulf rule. Br.22-26.

None of the SEC's additional cases presents anything new. McGann v. Ernst & Young, 102 F.3d 390, 396 (9th Cir. 1996), and Semerenko v. Cendant Corp., 223 F.3d 165, 175-77 (3d Cir. 2000), Op.Br.23, are just further cases involving accountants, who have long been subject to § 10(b) because of the duties created by their "special relationship with the investing public." Overton v. Todman & Co., 478 F.3d 479, 485 (2d Cir. 2007). The defendants agree that "any person" in theory can be covered by § 10(b) "regardless of who he is or what it is," Op.Br.24, but the cases show that such a person must be doing at least one of two things: trading in stocks or breaching a fiduciary or special duty. Without either of those factors, a misstatement may be subject to other claims – such as common law fraud – but it is not "in connection with the purchase or sale of any security."

The SEC's discussion of the cases on which the district court relied, Op.Br.27-29, is an exercise in avoidance of the central truth of those cases: all of the defendants were either trading securities or violating a duty. SEC v. Rana Research, 8 F.3d 1358 (9th Cir. 1993), described as involving a press release from a "financial consultant" who was "neither a fiduciary or a trader," Op.Br.26, is anything but. This "consultant" was in fact a broker who was trying to take over a public company, who had made a joint-offer for its stock with an investment bank, whose employees had purchased the stock, and who used the press release as a way to "pressure[]" the company into accepting his offer. See App.Dkt.40 at 3-4.

Trading a stock based on a statement by an issuer, as in In re Carter-Wallace Int'l Sec. Litig., 150 F.3d 153, 156 (2d Cir. 1998), by an investment adviser, as in Laird v. Integrated Resources, 897 F.2d 826, 835 (5th Cir. 1990), or by any other fiduciary, meets a reasonableness standard because such actors are under a duty to speak the truth to investors whenever they choose to speak. The SEC has recognized, in a related context, that impersonal investment advice does not meet this standard. When the draft of Regulation FD, which governs selective disclosures, was published for comment, it did not exclude disclosures from issuers to the media or investment newsletters. The SEC revised the language to cover disclosures only to certain parties: broker-dealers, registered investment advisers, registered investment companies, and holders of an issuer's securities who might be expected to trade on the disclosure:

> We have narrowed the coverage of the final regulation. The regulation is designed to address the core problem of selective disclosure made to those who would reasonably be expected to trade securities on the basis of the information or provide others with advice about securities trading.

See Final Rule: Selective Disclosure and Insider Trading, 2000 SEC LEXIS 1672, at *23 (Aug. 15, 2000). The SEC carved out investment newsletters because their advice is not "reasonably" connected to securities trading. Thus, Steven Wingfield's statements to the Author were not covered by Regulation FD. The content of an interview that the SEC deems unconnected to securities trading for the purposes of Regulation FD can hardly be found connected with securities trading under § 10(b).

The evidence from readers of the Report shows just how far removed this case is from the concerns about corporate and fiduciary conduct that animated Texas Gulf. None of the subscribers testified that they had a fiduciary relationship with the defendants. None stated that they received personalized investment advice. None said that they believed that the Report was actually published by USEC itself – i.e., by an issuer with fiduciary duties. They knew that they bought the Report from an independent publisher (and many of them asked for and received full refunds from the publisher). There is no basis here for "reasonable" reliance as there was in Texas Gulf, where an issuer, who has a duty to speak the full truth whenever it decides to speak, made statements to the market.

Nothing in the rejection of § 10(b) jurisdiction turns on whether the Report and E-mail were part of a regular stream of recommendations the defendants made to their readers or were "one-time" publications as the SEC insists. Op.Br.3. Nor does it depend on the existence of an ongoing publisher-reader relationship, id. at 2, though one certainly existed here. JA4550 (Customer Activity Chart). The defendants are not a seeking a special exemption as members of "the press" from a law of general applicability. Id. at 50-51. Section 10(b) does not apply because the statute does not cover speech about stocks in the absence of securities trading or fiduciary violations by the defendant – regardless of who is speaking.

D. Imposing Texas Gulf liability on the defendants would hold them to the same standard as issuers and other full-fledged fiduciaries.

In the face of the considerable authority holding that publishers have no fiduciary duties to readers or to the public, the SEC steers away from explicitly asking this Court to establish such duties. But the liability the SEC seeks to impose would effectively do the same thing. Because this case involves an alleged misrepresentation, as opposed to silence in violation of a duty to disclose,[3] and because defendants did not trade in USEC stock, to place them under the Texas Gulf rule would be to treat them as similarly-situated to all-purpose fiduciaries, such as issuers. Equating the duties of publishers of impersonal investment advice with the duties of General Electric or IBM would expand § 10(b) beyond its statutory – and constitutional – boundaries.

Issuers have a fiduciary obligation to speak the full truth regardless of whether the company or its officers are trading in the company's stock. See Raab v. General Physics Corp., 4 F.3d 286, 288 (4th Cir. 1993) ("The securities laws require General Physics to speak truthfully to investors."); City of Monroe Empl. Ret. Sys. v. Bridgestone Corp., 387 F.3d 468, 491 (6th Cir. 2004) (noting that a corporation has a "duty to speak truthfully as to the topics on which it [speaks]"); Flamm v. Eberstadt, 814 F.2d 1169, 1178 (7th Cir. 1987) ("[A public corporation] who speaks must tell the truth about important matters. The firm may be silent, leaving investors to take their chances, but may not lie ... .").

Thus, the duty the SEC seeks to impose on the Publisher and Author is a duty to the public to speak the full truth whenever they speak. This is precisely the

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[3] A duty to disclose may arise when "there is insider trading, a statute requiring disclosure, or ... an inaccurate, incomplete or misleading prior disclosure." City of Monroe Emp. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 669 (6th Cir. 2005) (quotations and citation omitted).

type of full-blown fiduciary obligation rejected in SEC v. Wall St. Publ'g Inst., 664 F. Supp. 554, 555-56 (D.D.C. 1986), rev'd on other grounds, 851 F.2d 365 (D.C. Cir. 1988), and Reliance Ins. Co. v. Barron's, 442 F. Supp. 1341, 1353 (S.D.N.Y. 1977). Br.29-30. The duty rejected in Wall Street was not a duty of disclosure, Op.Br.31, but a broader duty relating to misrepresentations when the publisher "undertook to supply information" about securities. 664 F. Supp. at 556.[4] The SEC calls this part of the opinion "erroneous" and "unreviewed" on appeal, Op.Br.16, 40, but the party who chose not to appeal this holding was the SEC.

Courts have also rejected affirmative duties for independent credit rating agencies. In dismissing § 10(b) counts against Standard & Poor's and A.M. Best, a federal court concluded:

> [Plaintiff's] citation of cases which call for complete and accurate information for investors as one of the basic objectives of Section 10(b) ... is inappropriate absent a duty on the part of either S & P or Best to inquire into the truth of the information they publish. ... The mere fact that S & P and Best made recommendations does not in this case entail a duty to inquire.

In Re Repub. Nat'l Life Ins., 387 F. Supp. 902, 905-06 (S.D.N.Y. 1975). Congress passed the Credit Rating Agency Reform Act in 2006 to give the SEC authority to prohibit "unfair, coercive, or abusive" practices by credit rating agencies. Pub. L.

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[4] See also SEC v. Wall St. Publ'g Inst., 591 F. Supp. 1070, 1074 (D.D.C. 1984) (SEC allegations against magazine concern "material misrepresentations").

109-291. The SEC believed that it "did not possess sufficient authority to regulate credit rating agencies without congressional action." S. Rep. 109-546 (July 7, 2006). In a similar vein, if the SEC is concerned that regulation of investment advice beyond the '40 Act is warranted, it must seek authority from Congress.

The defendants are not "confused," Op.Br.30, about the difference between fraud based on misrepresentation and fraud based on silence in the face of a duty to disclose. They have not, contrary to the SEC's claim, id. at 31, identified this case as the latter. It is the SEC's assertion that "only fraud through silence requires a breach of a fiduciary or other duty" that is confusing because it suggests that fiduciary breaches are irrelevant to misrepresentation cases. Id. at 30. Often, in fact, fraud by misrepresentation does require a breach of fiduciary duty, as in Carter-Wallace, where issuers made false statements but were not contemporaneously trading. A more precise statement would be that "only fraud through silence requires a breach of a duty to disclose."

The SEC suggests that the lack of fiduciary or special duty is not fatal to its claims because, citing a treatise, it states that "liability for misrepresentations flows absent a fiduciary or other duty." Id. at 31. But the SEC fails to mention that the very section of the treatise it cites is entitled "Misrepresentations and Omissions When Defendant Trades" (emphasis added), and the single case the treatise footnotes for the quoted statement is United States v. Cannistraro, 800 F. Supp. 30, 84 (D. N.J. 1992) – where the defendants were heavily engaged in trading stock. The law on this front is clear. Liability for misrepresentation can flow absent fiduciary duty when the defendant is trading. See Wharf, 532 U.S. at 591-96.

II. The SEC's brief shows that its claims against impersonal investment advice sound under the '40 Act, not § 10(b).

The SEC does not explain its decision, after threatening the defendants under the '40 Act, to proceed instead solely under § 10(b). Br.3-4, 32-33. But in its long discussion of the '40 Act and Lowe, the SEC shows itself to be very much interested in trying to convince this Court that the Report and the E-mail would not be protected under the '40 Act's bona fide publisher's exemption because they were not "general and regular." Op.Br.38-45. At best, this concerted effort only proves that the SEC should have tried to make its case under the statute specifically covering investment advice – the '40 Act.

The suggestion that the Supreme Court in Lowe approved using § 10(b) against financial writers similarly-situated to the Publisher and Author is without merit. The Court's reference, Op.Br.39, was specifically to authors who engaged in "the practice of 'scalping'" – secretly purchasing stocks before recommending them and profiting from the rise in price by selling them subsequent to publication. Lowe, 472 U.S. at 209 n.56. The use of § 10(b) against such persons was wholly appropriate because they were trading stocks. The Court's explicit recognition of the role of § 10(b) in "scalping" cases proves defendants' point – § 10(b) is the

SEC's tool to police improper trading. The '40 Act regulates investment advice.

If Congress intended for § 10(b) to cover persons who simply rendered impersonal stock recommendations, that intent certainly would have come up at some point in the legislative history of the statute Congress passed six years later to deal explicitly with investment advice (and which also includes its own anti-fraud rules) – the '40 Act. That there is silence on this subject speaks volumes.

III. First Amendment safeguards apply in this case, and independent review fails to show, by clear and convincing evidence, publication of a materially-false statement with actual malice.

The SEC argues that actual malice protections and independent appellate review have no role in this case because "fraud" is not protected by the First Amendment. Op.Br.46-51. The question is not whether fraudulent speech is constitutionally-protected. It is well-established that fraud, like libel, is actionable. But labeling a statement "libelous" does not abolish First Amendment protections, but rather triggers them. Therefore, when the SEC attempts to impose liability on the basis of pure expression, it must prove its claims consistent with First Amendment safeguards.

A. New York Times and Bose protect the speech of the defendants.

The SEC's principal argument as to why the speech in this case should be treated differently from other types of expression is its claim that allegations of "fraud" nullify constitutional concerns. Op.Br.47. Illinois v. Telemarketing

Assocs., 538 U.S. 600, 617 (2003), cited by the SEC, Op.Br.16, however, could not be more clear: "Simply labeling an action one for 'fraud,' of course, will not carry the day." See also Commodity Trend Serv. v. CFTC, 233 F.3d 981, 993 (7th Cir. 2000) ("[T]he government cannot label certain speech as fraudulent so as to deprive it of First Amendment protection.")

Thus, even if § 10(b) applies to these facts, the protections shielding the Publisher and Author when the SEC seeks to assert liability over their allegedly fraudulent speech are the very ones identified by the Supreme Court in Telemarketing Assocs.: a requirement of clear and convincing proof from the government, New York Times "actual malice" rules, and independent review of the entire record under Bose. 538 U.S. at 620-21.

The SEC argues that the lesser standards it wants to impose allow "abundant breathing space for speech" and that heightened standards would provide "only negligible (if any) additional breathing space." Op.Br.47, 50. The Supreme Court disagrees. It is the "exacting proof requirements" articulated above that are the ones that, in the Supreme Court's words, "have been held to provide sufficient breathing room for protected speech." Telemarketing Assocs., 538 U.S. at 620. Without them, § 10(b) is unconstitutional as applied to the defendants.

The SEC attempts to distance this case from New York Times on the grounds that the falsity alleged in the Report and E-mail is non-reputational.

Op.Br.49. What binds together the progeny of New York Times, however, is not simply preventing end-runs around actual malice protections through other torts involving harm to reputation, but a recognition that constitutional safeguards are needed whenever liability is sought over the alleged falsity of speech on public issues. The New York Times rules apply here, as they applied to the common-law fraud action over investment losses stemming from inaccurate financial reporting in First Equity Corp. v. Standard & Poor's, 690 F. Supp. 256, 258 (S.D.N.Y. 1988) (Mukasey, J.) because it is "consistent with well-established First Amendment principles requiring a plaintiff to demonstrate actual malice when seeking to impose liability ... for publication of a non-defamatory falsehood." See also County of Orange v. McGraw Hill Cos., Inc., 245 B.R. 151, 156-57 (C.D. Cal. 1999) (actual malice applied to alleged errors in bond ratings).

B. The commercial speech doctrine is inapplicable.

The SEC argues in the alternative that the Report and the E-mail do not deserve the constitutionally-mandated heightened standard of proof of New York Times and Bose because they are commercial speech. Op.Br.48. Citing Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York, 447 U.S. 557, 562 (1980), the district court held that the publications had "no purpose other than to 'propos[e] a commercial transaction'" and were "entitled to lesser protection under the First Amendment than the pure speech involved in Sullivan." JA177.

The SEC and the district court misapply the commercial speech doctrine, which courts have developed to evaluate the constitutionality of laws regulating particular types of advertising. See Central Hudson (electrical power); Lorillard Tobacco Co. v. Reilly, 533 U.S. 525 (2001) (tobacco). Section 10(b) is not a law regulating advertising per se, and the commercial speech doctrine is thus a poor analytical fit for this case.

Even more important, the Report is not an advertisement. It proposed no commercial transaction between readers and the defendants. A reader wishing to invest in USEC had to contact a broker to buy shares. The district court erred in ruling that merely recommending an item available for purchase (from a third party) turns fully-protected speech into commercial speech. A newspaper column reviewing a new car model, for example, does not become "commercial speech" because a reader can buy the new model from a neighborhood dealer. The court's holding thus directly conflicts with a large and well-established body of law fully protecting speech on a range of commercial products in the marketplace, including securities. See, e.g., Bose v. Consumers Union of U.S., 466 U.S. 485, 487 (1984) (stereo speakers); Biospherics v. Forbes, 151 F.3d 180, 182 (4th Cir. 1998) (securities).

In trying to distinguish Lubin v. Agora, 882 A.2d 833 (Md. 2005), the SEC emphasizes that when the Maryland court refused to apply the commercial speech doctrine, it was "addressing only the Special Report," not the E-mail (Op.Br.49 n.8) – a tacit concession that there is no basis to argue that the Report, which proposed no transaction between the defendants and readers, is commercial speech.

As for the E-mail, it is an advertisement, and there is no doubt that the FTC and state agencies have jurisdiction to enforce false advertising laws if, for example, a publisher advertises a newsletter as covering international securities, and the newsletter discusses only domestic stocks. But courts have refused to apply the commercial speech doctrine to advertisements that, like the E-mail, mirror statements contained in the advertised publication. Thus, in Lane v. Random House, 985 F. Supp. 141, 152 (D.D.C. 1995), the court held that an advertisement for a book on the Kennedy assassination was not commercial speech: "[T]he challenged advertisement is not about laundry detergent; it cannot be divorced from the book ... and the book is protected speech." See also Bolger v. Youngs Drug Products Corp., 463 U.S. 60, 67 n.14 (1983) (noting that advertisement for religious book cannot be regulated as commercial speech).

In any event, the E-mail, which does not name USEC, cannot by the SEC's own test meet the "in connection with" requirement because no one could trade (let alone be "virtually certain" to trade) on a publication that does not identify a stock.

C. That purchasers of the Report bought USEC stock does not demonstrate its materiality.

The SEC's claims on materiality merely echo its arguments on the "in connection with" requirement: that because readers of the Report purchased shares in USEC, the Report must have been material. The government makes this assertion while at the same time ignoring, as the district court did before it, the large volume of information entering the market about USEC in the weeks leading up to the Moscow summit, from USEC's own statements and the statements of President Bush to the fervent speculation in the daily and financial press about the impact of superpower deal-making at the summit on the pending pricing agreement between USEC and Tenex. Br.41-46.

The subscriber testimony on which the SEC bases its case for materiality shows that readers readily understood that the defendants were not their fiduciaries and therefore that they needed to filter and evaluate the Report in that light – or, as one subscriber put it, "I don't rely on Mr. Stansberry to tell me when to get up in the morning or go to bed or go to the bathroom. His contention was that the stock was going to double ... and it was up to us to decide when to buy, whether to buy, how much to buy." JA2102-03 (emphasis added). Almost all of the readers performed some independent research on USEC. Some did so on the Internet. See, e.g., JA2246-67, 2528-29. Some called brokers. See, e.g., JA2717-18. Some called USEC itself. See, e.g., JA2266-67. Some bought options (when the Author said not to). See, e.g., JA2458-58. One subscriber found the stock attractive without the claim of "insider" information based simply on the information "about the company itself" in the Report. JA2526.

The SEC does not contest Dr. Comment's opinion that the publication of a specific day for the announcement of the contract approval – May 22 – could not have altered the total mix of information. Op.Br.56; Br.44-45. But it does dispute his related point that if anything in the Report was material it was management's view that a "tie" existed between the summit and the pricing agreement. The SEC calls it "implausible" that such a tie could have been true, as Dr. Comment believes it is, because approval did not come until "weeks after" the summit. Op.Br.56.

But in the world of international geopolitics (with a nuclear twist), that it only took weeks after the summit to announce the signing of the agreement is close to a miracle. The SEC tries to discount the evidence supporting the truth of the "tie," including the Bank of America and Wingfield memoranda, by saying that these documents could not have affected the total mix of information available because they were not publicly circulated. Op.Br.54 n.13. But the defendants did not reference the memoranda to prove their impact on investors in the market. They referenced them to prove truth. Br.45.

The gist of the SEC's remaining argument is that this Court should not look too deeply into the record. The identification of numerous confounding factors by the defendants impacting the movement in the price of USEC stock is "only one piece of evidence bearing on materiality," according to the SEC, and the district court has provided a "reasonable explanation" for its contrary findings. Op.Br.55. The district court's "reasonable explanation" failed to even mention the only expert to testify on materiality at trial (Dr. Comment), much less counter his testimony that the rise in the stock's price was attributable to information other than in the E-mail or Report. Br.42-44. Under either a clear error or independent review analysis, the district court's findings on materiality are insufficiently supported to be sustained.

D. There is no evidence, let alone clear and convincing evidence, that the defendants published a false statement with actual malice.

The SEC follows the district court's lead in treating the fault component of its claim almost as an afterthought. It asserts that the district court's "factual findings would easily withstand independent review under Bose," Op.Br.50 n.11, without actually examining how this Court would assess the record under such a comprehensive analysis. Nor does the SEC attempt to distinguish the facts and outcome in Bose itself, which the defendants discussed in detail specifically to show how a reviewing court conducts independent appellate review and relies on its own inferences from the evidence when those of the lower court are improper, as is the case here. Br.48-50.

The SEC denies that the district court "confused proof of falsity with proof of fault" only by referencing the court's conclusory findings that the Author knew what he printed was false and by arguing that he therefore "affirmatively lied about what Wingfield told him." Op.Br.57 (emphasis in original). The SEC makes no attempt to show that "clear and convincing" evidence exists to support the district court's leap in logic, Op.Br.59, and thus simply embraces the court's error. Furthermore, the SEC asserts that the defendants ignore evidence of "red flags" and "deceptive intent" in the record, Op.Br.19, 59 – but then is unable to back up that claim with any facts.

IV. The injunctive relief, now stayed, would violate the Constitution.

The SEC does not argue that the stay of the injunctive relief pending appeal was granted in error. In fact, the government proceeds with its claims for injunctive relief without acknowledging this Court's intervention and the potential implications of that intervention on the SEC's case.

The SEC characterizes the injunction as merely a proscription against "the repetition of conduct that has been found to be illegal." Op.Br.6. If that were true, the Author and Publisher would be enjoined specifically from republishing what they have already published. That is not the case here. The injunction instead takes the broadest approach it could by enjoining the defendants in the very language of Rule 10b-5 itself. JA199-207. It is precisely the sort of "obey the law" injunction that a majority of the federal appeals courts have held impermissible under the specificity requirement of Fed. R. Civ. P. 65(d). See, e.g., SEC v. Smyth, 420 F.3d 1225, 1233 n.14 (11th Cir. 2005). In neither of its efforts to distinguish Lubin, Op.Br.42, 49, does the SEC address the insurmountable problem Lubin creates for an "obey the law" injunction – the district court and the unanimous Maryland Court of Appeals disagree about what "the law" is as it pertains to constitutional protection for the Report and E-mail, highlighting exactly why there is such a strong presumption against prior restraints.

It is no defense of the constitutionality of the injunction to argue that the district court has simply prohibited "fraudulent speech" which is "not protected by the First Amendment." Op.Br.59-60. Once again, the SEC puts the cart before the horse. The Supreme Court would no more allow a court to enjoin future "fraudulent speech" in the abstract than it permitted the lower court in Near v. Minnesota to ban future publication of a "defamatory newspaper." 283 U.S. 697, 706 (1931); Br.56. See also Telemarketing Assocs., 538 U.S. at 612 (noting that the Court has "three times considered prophylactic statutes designed to combat fraud by imposing prior restraints .... [and] [e]ach time, the Court held the prophylactic measures unconstitutional").

The injunctive relief in Nat'l Soc. of Prof. Engineers v. United States, 435 U.S. 679, 697 (1978), Op.Br.60, involved conduct – the restraint of trade – and the removal of specific language from a code of ethics and policy statements which created that restraint by implying that competitive bidding was unethical. See also 389 F. Supp. 1193, 1216 (D.D.C. 1974). It was not a sweeping, open-ended restriction on pure speech as is the case here. The detailed injunctions in United States v. Raymond, 228 F.3d 804, 808 n.2 (7th Cir. 2000) and United States v. Bell, 414 F.3d 474, 477 n.3 (3d Cir. 2005), Op.Br.60, covered specific commercial speech inciting violation of the tax laws that was unprotected under Brandenburg v. Ohio, 395 U.S. 444, 447 (1969). See Raymond, 228 F. 3d at 815; Bell, 414 F.3d at 481. In contrast, the broad injunction in this case is not limited to the precise content of the E-mail and the Report and reaches all of the speech of the defendants, who publish writings that the district court concedes deserve "substantial First Amendment protection." JA148.

Those "substantial First Amendment protections" are reduced to a nullity under the court's permanent injunction. The injunction violates the Constitution.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6997 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally-spaced typeface using Microsoft Word 2003 in 14-point Times New Roman font.

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25th day of July, 2008

CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of July, 2008, I caused two copies of the foregoing Reply Brief of Appellants-Defendants for Reversal of the District Court's Decision, which was also filed via CM/ECF and sent to the Clerk of Court by FedEx Overnight this same day, to be served via CM/ECF and FedEx Overnight on:

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