SCHEDULED FOR ORAL ARGUMENT ON FEBRUARY 6, 2012

In the

United States Court of Appeals

for the

District of Columbia Circuit

11-1082

DAN RAPOPORT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR REVIEW OF AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION IN CASE NO. SEC-REL34-63744

FINAL REPLY BRIEF FOR PETITIONER

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GLOSSARY

Term:	**Defined Herein As**:
ALJ	Administrative Law Judge
Adopting Release	The August 15, 1989 Adopting Release for Rule 15a-6 titled "Registration Requirements for Foreign Broker-Dealers"
Commission or SEC	Respondent Securities and Exchange Commission
Chekholko	OIP Respondent Vladimir Chekholko
CI-Moscow	OOO CentreInvest Securities, Rapoport's Moscow-based employer
CI-New York	CentreInvest, Inc., CI-Moscow's affiliated, registered New York broker dealer
Decision	The SEC Order denying Rapoport's Motion to Set Aside the Default Order dated January 21, 2011
Division	SEC's Division of Enforcement
Default Order	The Order Making Findings and Imposing Sanctions by Default as to CentreInvest, Inc., Dan Rapoport, and Svyatoslav Yenin dated July 31, 2009
FINOP	Financial and Operations Principal
FRCP 55(c) or Rule 55(c)	Federal Rule of Civil Procedure 55(c)
Herlyn	OIP Respondent William Herlyn
OIP	The SEC Order Instituting Proceedings dated December 8, 2008

OIP Respondents	Rapoport; CI-Moscow; CI-New York; Chekholko; Herlyn; and Yenin
Proposed Amendment	The SEC's July 2008 Proposed Rule on Exemption of Certain Foreign Broker Dealers
Rapoport	Petitioner Dan Rapoport
Rule 15a-6	17 C.F.R. 240.15a-6
SEC Rule 155(b) or Rule 155(b)	17 C.F.R. 201.155(b)
Section 15(a)	Section 15(a) of the Securities and Exchange Act of 1934, 15 U.S.C. 78*o*(a)
Yenin	OIP Respondent Svyatoslav Yenin

STATUTES

The relevant statutory provisions, not otherwise provided in Petitioner's Opening Brief or in Respondent's Opposition Brief, are attached in an Addendum pursuant to Circuit Rule 28(a)(5).

SUMMARY OF ARGUMENT

Rapoport's Petition[2] demonstrated that after the Division filed an OIP accusing Rapoport of violating hyper-technical registration requirements that the Commission had proposed *eliminating* six months *prior* – and after the Division made no effort to serve Rapoport with its flawed allegations in Moscow, where he worked and resided, and instead obtained a default order based on service "directed" on Rapoport's limited-purpose U.S. counsel – the Commission abused its discretion by refusing to even consider Rapoport's obviously meritorious defenses when Rapoport moved to set aside the Default Order almost immediately after he was served personally for the first time.

The SEC responds[3] that it had discretion to reject the three-factor test that is universally-applied to determine whether "good cause" exists to set aside a default, but the SEC has no such discretion here. To rationalize its erroneous rejection of the settled "good cause" standard, the SEC invents an SEC-specific standard that is contrary to the law in this and other Circuits, and argues that this bespoke standard is entitled to agency deference. The SEC's "standard" – fabricated solely for the purpose of this litigation – contradicts the plain language of the SEC's own rule, as

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[2] Cited herein as ("P. at __.")

[3] The SEC's November 10, 2011 brief in opposition is cited herein as ("Opp. at __".)

well as the arguments made by the Division and the ALJ below, who relied almost exclusively on the federal court "good cause" standard. The SEC's imagined standard is entitled to no deference by this Court because it relates to a question of judicial review that is outside the SEC's expertise, and cannot apply here, where the SEC requires federal jurisdiction to enforce the civil penalties in the Default Order.

Rapoport's Petition further demonstrated that the SEC thoughtlessly imposed on Rapoport severe penalties, by default, that find no support in the Division's allegations, let alone the evidence. The SEC effectively concedes that it failed to meaningfully consider (i) all penalties against Rapoport attributable to 2003-2005 and (ii) $315,000 in "second-tier" civil penalties, but argues that this failure was harmless because these sanctions are supported by the OIP's allegations, which must be accepted as true on default. The SEC's after-the-fact reliance on these allegations is no substitute for the requisite "meaningful consideration" of these penalties. Moreover, the allegations identified by the SEC -- generic legal conclusions contradicted by the specific allegations in the OIP and the Division's evidence -- cannot support sanctions against Rapoport. Therefore, in the event the Default Order is not set aside in its entirety (and it should be), all such penalties must be eliminated.

ARGUMENT[4]

I. The SEC Abused Its Discretion When It Rejected The Universally-Applied "Good Cause" Standard

The SEC does not dispute that it expressly rejected the three-part test for "good cause" that is mandatory in this and other Circuits. *Keegel v. Key West & Caribbean Trad. Co.*, 627 F.2d 372 (D.C. Cir. 1980). This test – that the Court must consider each of three factors (*i.e.*, willfulness, defenses, and prejudice) and balance the equities – has been settled law in this Circuit for more than three decades, and was adopted in accord with the "modern" view favoring trials on the merits. (P. 16-19).[5] The SEC claims that certain other Circuits permit courts to deliberately disregard the three factors, but none of the SEC's cases (Opp. at 23) supports this erroneous proposition.[6]

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[4] With respect to the applicable standard of review, the SEC ignores, and thus concedes, that given the policies favoring resolution of disputes on their merit, an abuse of discretion in failing to set aside a default judgment "need not be glaring to justify reversal." (P. at 16.)

[5] The SEC cites (Opp. at 23) two in-circuit cases that offer no support for the SEC's position that the three-factor test is "not talismanic" because in both inapposite cases (which pre-date the "modern" view) the Court denied a motion to set aside a default *judgment* (not order) brought by a party that *was* personally served, offered *no* proposed defenses to the Court, and offered *no* reason for failing to appear. *See Hughes v. Holland*, 320 F.2d 781, 782 (D.C. Cir. 1963); *Draisner v. Liss Realty Co.*, 211 F.2d 808, 809 (D.C. Cir. 1954).

[6] *See Coon v. Greniner*, 867 F.2d 73, 76 (1st Cir. 1989) (applying the three-factor test and stating that the three-part test provides "general guidelines" of "fairly universal application"); *see also Compania Interamericana Export-Import v. Compania Dominicana de Aviacion*, 88 F.3d 948, 951 (11th Cir. 1996) (noting

The SEC argues (Opp. at 19-21) that disregarding Rapoport's defenses was not an abuse of its discretion because the SEC is not subject to the federal rules, and because the SEC's unique rules permit it to ignore a defaulting party's defenses when deciding a motion to set aside a default. The SEC is wrong.

The SEC's rules apply the exact same test as federal courts for setting aside defaults: "good cause." *Compare* FRCP 55(c) *to* SEC Rule 155(b). The SEC's argument (Opp. at 21-24) that it has discretion to interpret "good cause" in a manner that fails to balance the equities and disregards settled federal jurisprudence and is baseless and false for several reasons.

First, the SEC's argument that it has its "own" interpretation of "good cause" that does not require a balancing of factors, including the defaulting party's defenses, is a *post hoc* rationalization of its flawed decision. Rule 155(b) expressly mandates that the defaulting party "specify the nature of the proposed defense in the proceeding." Rule 155(b) does not say – as the SEC now argues (Opp. at 24-27) – that the SEC can *ignore* these proposed defenses if the defaulting party fails to "justify his conduct." The SEC's so-called "interpretation" of its own rule is

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that the three-part test provides "general guidelines" that "are commonly applied"); *In re Dierschke*, 975 F.2d 181, 183 (5th Cir. 1992) (holding that "the district court *should consider*" the three-part test and recognizing that the district judge had appropriately "entertained argument" on all three factors) (emphasis added.)

therefore inconsistent with the text of the rule itself,[7] and the SEC has never taken this illogical interpretation of Rule 155(b) in the past.[8] Contrary to the SEC's novel position invented for this litigation, the plain language of Rule 155(b) requires a balancing of factors that mandates consideration of a party's proposed defenses. And the SEC's standard for setting aside a default is – as with FRCP 55(c) – "for good cause shown."[9]

The SEC's argument (Opp. at 24) that the FRCP 55(c) standard is "inapplicable" to proceedings before the Commission is also confuted by the proceedings before the Commission here. In his March 22, 2010 decision, the ALJ recognized that FRCP 55(c) was "similar" to Rule 155(b), and expressly relied on federal case law interpreting FRCP 55(c) – and purported to balance the three

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[7] The SEC's holding that Rapoport "denied himself the opportunity to present [his] defenses when he failed to file a timely answer to the OIP" is also flatly inconsistent with Rule 155(b)'s requirement that a motion to set aside a default be made "within a reasonable time" of the default. JA 1171-73.

[8] None of the Commission's decisions (Opp. at 21) reflects the SEC intentionally disregarding a defaulting party's proposed defenses.

[9] The SEC suggests (Opp. at 24, fn. 6) that some federal courts have, like the Commission, rejected the three-part test and "declined" to consider a party's defenses upon a finding of "willfulness." The SEC's cases do not support such a proposition; rather, they confirm that the "good cause" analysis requires a balancing of the equities. *See, e.g.*, *Waifersong, Ltd., Inc. v. Classic Music Vending*, 976 F.2d 290, 292 (6th Cir. 1992) (noting that if the Court were being asked to set aside an entry of default [rather than a default judgment], "a dramatic balancing of the [three] factors would be required").

factors – when he refused to set aside the Default Order. JA 715-16. [10] Rapoport and the Division *both* framed their argument to the Commission in terms of the three-part standard for "good cause," and *both* relied almost exclusively on FRCP 55(c) case law.[11] At no point during the proceedings below did the ALJ or the Division ever argue that FRCP 55(c) did not apply to Rapoport's motion, or that "good cause" before the SEC requires more than "good cause" in federal courts.[12]

Second, even if the SEC had its "own" interpretation of "good cause" (Opp. at 17-20) – and it does not – that interpretation would be entitled to no special deference here, because agency deference applies only to rules within the agency's "particular expertise and special charge to administer." *Prof. Reactor Operator*

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[10] The ALJ decided Rapoport's December 23, 2009 motion to set aside the default notwithstanding the fact that the ALJ's authority to issue an initial decision expired on October 8, 2009. *See* SEC Rule 360(a)(2); JA 937-40. This necessitated a second appeal by Rapoport to the Commission, which then applied a standard for "good cause" completely different from the ALJ.

[11] JA 736-38; JA 913-17. The proceedings before the Commission relied on the federal rules in other instances as well, including the ALJ's reliance on federal cases interpreting FRCP 56 in its initial decision concerning CI-Moscow (JA 470), and the SEC's reliance on case law interpreting FRCP 60 (the inapposite rule concerning default judgments) in the Decision. JA 1170 (n.28).

[12] *See also, e.g.*, *In re WSF Corporation*, Admin. P. 3-10668 (March 1, 2002), *available at* http://www.sec.gov/alj/aljorders/2002/3-10668.pdf (noting that "Rule 155(b) of the Commission's Rules of Practice is to the same effect" as FRCP 55(c)); *In re Muth et al.*, Admin. P. 3-11346 (Jan. 21, 2004), *available at* http://www.sec.gov/alj/aljorders/2004/3-11346-2.pdf (recognizing the *Division' s* argument that the Commission's Rules of Practice "follow the scope of the FRCP").

Soc. v. United States Nuclear Regulatory Comm., 939 F.2d 1047, 1051 (D.C. Cir. 1991); *see also Love v. Thomas*, 858 F.2d 1347, 1352 (9th Cir. 1988)("deference" given to agency interpretations "does not extend to the question of judicial review, a matter within the peculiar expertise of the courts"); *SEC v. Csapo*, 533 F.2d 7, 13 (D.C. Cir. 1976).

The SEC's argument (Opp. at 19-20) that its purported interpretation of Rule 155(b) is entitled to deference is grounded entirely on superficial language in case law. But in all of these cases, the agency rules or regulations "deferred to" related *substantively* to the agency's area of regulation, and are therefore inapposite.[13] Not

[13] *Auer v. Robbins*, 519 U.S. 452, 461 (1997) (deference to Secretary of Labor's interpretation of the Fair Labor Standards Act in devising a formula for overtime pay); *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 526 (1978) (deference to Atomic Energy Commission's nuclear power licensing procedures, which were consistent with Congress' delegation of "broad regulatory authority over the development of nuclear energy"); *FCC v. Schreiber*, 381 U.S. 279, 294 (1965) (deference to FCC-created rule requiring public disclosure of investigatory proceedings where public disclosure was necessary to carry out, *inter alia*, the FCC's statutory reporting requirements); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413 (1945) (deference to the Administrator of the Office of Price Administration's expertise in emergency price control and stabilization laws); *Intermountain Ins. Serv. of Vail v. Comm'r*, 650 F.3d 691, 707 (D.C. Cir. 2011) (deference to IRS decision involving the "complex administrative system for assessing tax deficiencies and his expert interpretation of technical statutory language"); *Kornman v. SEC*, 592 F.3d 173, 185 (D.C. Cir. 2010) (deference to SEC rule fully consistent with federal analog where SEC was seeking to enforce associational bar); *Blackmon-Malloy v. U.S. Capitol Police Bd*., 575 F.3d 699 (D.C. Cir. 2009) (deference to agency that was created to administer employee grievances in interpreting statutory provisions related to employee mediation); *Assoc. of Bus. Advocating Tariff Equity v. Hanzlik*, 779 F.2d 697, 701 (D.C. Cir. 1985) (deference to Federal Energy Regulatory Commission and Economic

one of the SEC's cases addresses an agency interpretation of a rule that – like Rule 155(b) here – is unrelated to the agency's expertise, concerns a matter of judicial review, and is directly at odds with federal law. The SEC has no special expertise interpreting the universally-applied "good cause" standard for setting aside defaults, and its purported "interpretation" of that standard is entitled to no special deference.

Third, the SEC cannot apply a "good cause" standard at odds with FRCP 55(c) where, as here, federal courts have exclusive jurisdiction to enforce the civil penalties imposed on Rapoport in the Default Order. Federal district courts have "exclusive jurisdiction" over "any suit or action to enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder," *see* 15 U.S.C. §78aa, which include second-tier civil penalties imposed by the Commission. *See* 15 U.S.C. §78u-2. The Commission must commence a federal court action to obtain an enforceable judgment against Rapoport, *see, e.g., SEC v. Chekholko*, SDNY, 09cv6937, and federal standards applicable to setting aside

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Regulatory Administration's determination with respect to decision on the importation of natural gas from Algeria); *McClelland v. Andrus*, 606 F.2d 1278, 1286 (D.C. Cir. 1979) (*reversing* an agency's decision to deny discovery of investigative report because the decision "could do violence to our conception of fair procedure and due process"); *NRDC v. SEC*, 606 F.2d 1031, 1056 (D.C. Cir. 1979) (deference to SEC's expertise in promulgating corporate disclosure rules).

defaults will apply.[14] The SEC therefore cannot apply its "own" interpretation of "good cause" here.

II. It Was Not "Harmless Error" For The SEC To Apply The Wrong Standard For "Good Cause"

The SEC abused its discretion by rejecting the mandatory, universally-applied three-factor balancing test, and the SEC's belated attempt to argue these factors to the Court misses the point completely.[15] To the extent relevant here, however, it was case-dispositive – not "harmless error" (Opp. at 30-34) – for the Commission to ignore these factors. (P. at 19-21.)

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[14] This Circuit's standards and case law – including the mandatory three-part test for good cause – are uniquely relevant because this Court is the only appellate venue available to a foreign resident like Rapoport. *See* 15 U.S.C. § 78y(a)(1) (foreign residents with no principal place of business in the United States must file petitions in this Circuit); *see also In the Matter of Lambert D. Vander Tuig*, 2000 SEC LEXIS 1866, at *6 n.1 (Aug. 16. 2000) (Commission following Ninth Circuit's interpretation of FRCP 54(c) where Ninth Circuit would be the "appellate venue" for review of the Commission's order).

[15] This Court need not engage in the balancing that the Commission erroneously failed to perform, because only "[w]hen there is not the slightest uncertainty as to the outcome of a proceeding on remand . . . can [courts] affirm an agency decision on grounds other than those provided in the agency decision." *Manin v. NTSB*, 627 F.3d 1239, 1243 (D.C. Cir. 2011) (internal quotation omitted).

A. Rapoport Demonstrated Far More Than The Requisite "Hint Of A Suggestion" Of A Complete Defense

The SEC's argument (Opp. at 30-34) that Rapoport has not proffered a "meritorious defense" (i) misstates Rapoport's proposed defenses, (ii) disregards the relevant standard, and (iii) misconstrues Rapoport's argument on appeal.

First, by arguing that exemptions to registration are inapplicable to Rapoport's conduct, the SEC assumes incorrectly that Rapoport – who worked and lived at all relevant times in Moscow, Russia – was required to register with the SEC at all. Rapoport's principal defense to the OIP is that *virtually all of his conduct did not require him to register with the SEC*. (P. at 19.) Rule 15a-6's exemptions are therefore relevant to Rapoport's defenses only to the extent that the SEC first proves that Rapoport "solicited" U.S. investors, which requires a "case-by-case determination." (P. at 20, fn. 11.) To the extent any of Rapoport's conduct was "solicitation" at all, Rapoport will show that conduct did not require him to register because it involved effectuating non-solicited trades (Rule 15a-6(a)(1)); trades based on research furnished to major U.S. institutional investors (Rule 15a-6(a)(2))[16]; and trades with broker-dealers and other qualified investors (Rule 15a-

[16] The SEC incorrectly states (Opp. at 32) that the exemption for furnishing research reports to U.S. investors required CI-New York to maintain records that it did not. Where the foreign-broker dealer does not establish a "chaperoning" relationship with the U.S.-registered broker-dealer – as the SEC alleges here – the

6(a)(4)). (P. at 20.) Contrary to the SEC's inaccurate assertion (Opp. at 30-32), none of these exemptions to registration requires that CI-New York maintain records or register the foreign broker-dealer for service.

Second, the SEC's argument (Opp. at 30) that Rapoport bears a "burden" to "prove" his meritorious defense egregiously contorts the relevant standard. (P. 19.) A defaulting party alleges a "meritorious defense" where its allegations "contain even a hint of a suggestion which, proven at trial, would constitute a complete defense," and even "broad and conclusory" allegations suffice to make this showing. *Keegel*, 627 F.2d at 374 (defaulting party need not "prove a defense" to demonstrate good cause, and "likelihood of success is not the measure"). The SEC conflates Rapoport's burden of showing a "meritorious defense" to set aside the Default Order with the fact that Rule 15a-6 – the *de facto* registration requirements for foreign broker-dealers (P. at 5-7) – provides affirmative defenses at trial to "solicitations" found to violate Section 15(a).

Third, the SEC's argument (Opp. at 30-34) that Rapoport did not satisfy this non-existent "burden" is preposterous, given that Rapoport *did* set forth his defenses in extraordinary detail for the Commission, but the Commission ignored these defenses completely. Rapoport has not only repeatedly set forth his proposed

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research report exemption does not require the registered broker-dealer to maintain records. *See* Rule 15a-6(a)(2)(iii).

defenses to the OIP,[17] but he has responded to the Division's best "evidence"[18] – demonstrating compelling and dispositive defenses – without the benefit of contradictory or explanatory evidence, discovery or cross-examination. But the Commission ignored these arguments entirely.[19]

Tellingly, as its "one example" (Opp. at 31) of Rapoport's supposed failure to "prove" his defenses, the SEC argues that Rapoport does not "state that the investors in this case fit into any of the categories" for the Rule 15a-6(a)(4) exemption. Yet Rapoport made precisely that argument to the Commission below with respect to the only "investor" identified by the Division (JA 1082-83), and the SEC has never identified the *only* other "investor in this case." As this "one example" demonstrates, the SEC's so-called evidence that Rapoport solicited U.S. investors while working in Russia from "about 2003-2007" is extraordinarily

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17 JA 513-20; JA 695-708; JA 727-899, JA 1066-1159.

18 JA 701-02; JA 733-36; JA 1079-85.

19 Notably, it was the Division that failed to "detail" its factual allegations against Rapoport. The December 8, 2008 OIP did not identify a single specific "direct" or "indirect" solicitation by Rapoport, and the Division refused to provide Rapoport with the factual basis for its allegations before filing the OIP. JA 702; JA 587-605.

attenuated with respect to 2006 and 2007, and non-existent with respect to 2003, 2004 and 2005.[20]

B. Setting Aside The Default Will Not Prejudice The Division

The SEC recognizes that delay does not constitute "prejudice" (P. at 20-21), and therefore argues that "the concern is the loss of evidence cause by the delay." (Opp. at 34.) The SEC offers no support for this empty and false assertion. The Division's purported evidence is preserved, has been marshaled in briefing to the ALJ and Commission, and includes records obtained from CI-New York and CI-Moscow, as well as affidavits from cooperating co-respondents and investors.[21] Conversely, because Rapoport was fired from CI-Moscow on February 2, 2008 and prevented from recovering his files and documents (JA 517; JA 587-605), he lacks access to materials critical to his defense. Rapoport can and will establish his defenses notwithstanding, but the SEC's claim of "prejudice" based on the theoretical loss of evidence is baseless. It is also immaterial, because the Commission erred by failing to consider it below.

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[20] As set forth in Section II(A) *infra*, the Division has no evidence to support any violation by Rapoport from 2003-2005, nor are there well-pleaded allegations in the OIP to support such a finding.

[21] JA 587-695. The Division also has, "as a result of the examination that began in April 2007 . . . thousands of documents," in hard-copy and electronic format, copied from CI-New York's files. JA 1053-1065.

C. The Commission Erred In Its Consideration Of The "Willfulness" Of Rapoport's Default

The SEC argues (Opp. at 24-29) that it "properly exercised its discretion" to refuse to set aside the Default Order because Rapoport did not "offer any reasonable explanation" for "his failure to file an answer"; lacked "an acceptable reason" for failing to appear; "cannot justify [his] failure to answer," and did not "justify his conduct to the Commission." These attempts to reformulate the "willfulness" prong of the "good cause" analysis have no basis in Rule 155(b) or the Commission's decisional law, and should be afforded no deference.[22] Regardless of how the issue is framed, however, the SEC erred by disregarding factors critical to the "good cause" analysis. (P. at 21-22)

First, it is not Rapoport's "mere act" of moving to set aside the default (Opp. at 26) that demonstrates Rapoport's reasonable belief that personal service was required to effect service. To the contrary, it is *timing* of that act, and the *fact* that almost immediately after he *was* personally served, he appeared to defend the action. The SEC does not and cannot dispute that Rapoport was found in default *before* he was personally served, and that *after* he was personally served, he appeared to defend the action. (P. at 21-22.) Failing to address this fact was

[22] *See supra* at 6-8; *see also, e.g., SEC v. Rosenthal*, 650 F.3d 156, 160 (2d Cir. 2011) ("the *Chevron* framework is inapplicable where, as here, the agency's interpretation is presented in the course of litigation and has not been articulated before in a rule or regulation") (internal citations omitted).

contrary to the principle that doubts should be resolved in Rapoport's favor (P. at 17; 22-23), and the Commission failed to balance this crucial point with Rapoport's meritorious proposed defenses.

Second, the fact that Rapoport's "default" was based on invalid service on his limited-purpose counsel in Washington, D.C. is hardly immaterial (Opp. at 27) to the "good cause" analysis.[23] The SEC concedes that service on Rapoport's limited purpose U.S. counsel would be invalid under SEC Rule 141(a)(2)(iv) if directed service on counsel was prohibited by Russian law, but argues that "Rapoport has never demonstrated that Russian law prohibited service through Kraut." The SEC fails to explain why it was Rapoport's burden to retain a Russian legal expert to make that showing (given that the Division was seeking to serve Rapoport by extraordinary means),[24] and in any event, it appears that Russian law *does* prohibit such directed service.[25] That the SEC is forced to rely (Opp. at 27) on FRCP 4(f)(3) to salvage a method of service on Rapoport that is prohibited by

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[23] The SEC contends that Rapoport did not raise this argument before the Commission, and he has thus waived it." To the contrary, Rapoport raised the argument several times below. JA 501-03; JA 730-31; JA 1086.

[24] The SEC also concedes that service of the motion for a default order on Kraut was made *after* Kraut withdrew as Rapoport's attorney, and that the Division never attempted to serve the motion on Rapoport. JA 1166.

[25] Tatyana Gidirimski, *Service Of United States Process In Russia Under Rule 4(f) Of The Federal Rules Of Civil Procedure*, 10 Pac. Rim. L. & Poly. J. 691, 710 (2001) ("There is no evidence that Russia has ever recognized private service of foreign process by means other that through letters of request . . .").

the SEC's "own" rules illustrates that the SEC's attempt to disclaim FRCP 55(c) is specious, especially given that FRCP 4(f) and its SEC analog differ in material respects.[26] The salient point, however, is that the Commission should have factored the invalid[27] service on Rapoport into its "good cause" analysis, but did not.

Lastly, the SEC contends (Opp. at 29) that Rapoport did not move to set aside the default "within a reasonable time" because the "five-month gap" between the July 31, 2009 Default Order and Rapoport's December 23, 2009 motion

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[26] JA 61-62; JA 18-19, fn. 4; JA 1168. Contrary to the SEC's false assertion (Opp. at 20, fn. 5), the SEC regularly relies on analogous federal rules regardless of whether the commentary to the SEC rules states specifically that the SEC rule is patterned on the federal rule.

[27] Directed service on Rapoport through Kraut was questionable at best. Rapoport retained Kraut on September 8, 2008 – months after the Division completed its investigation into CI-Moscow and provided Wells notices to the OIP Respondents – to "review and analyze the Division's recommendation of this enforcement action, to possibly prepare a Wells Submission, and to possibly negotiate a resolution of the matter . . ." JA 54. The SEC inexplicably denied Kraut's repeated requests for the Division to provide the factual basis for the Division's claims (JA 587-605), and then filed an OIP on December 8, 2008 that provided no detail concerning the alleged "direct and indirect" solicitations by Rapoport. The Division made no attempt to serve Rapoport in Russia, but instead moved on December 15, 2008 (JA 43-40; JA 41-53) to serve Rapoport through Kraut. Two days later, on December 17, 2008, the Division advised Kraut that certain materials were available for inspection, but only if Rapoport consented to service. JA 1051-52. Ultimately, the ALJ ordered directed service on Rapoport (JA 66-70; JA 116-20) by effectively concluding that *because* Kraut contested service, Kraut's representation was sufficiently robust to deem Rapoport served through Kraut, and Rapoport could be served through Kraut.

"indicates that Rapoport apparently made no effort to monitor the Commission proceeding."[28] Given that Rapoport lived in Russia and was not served personally until October 23, 2009, the duration of the "gap" is immaterial. Knowing this, the SEC argues that (Opp. at 29) that Rapoport should have filed sooner after he was personally served "given what was at stake." But as the SEC also knows, Rapoport moved to set aside the Default Order approximately three weeks after the Division advised Rapoport's newly-retained counsel that it was not interested in negotiating a settlement. JA 492.[29]

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[28] The SEC relies on cases (Opp. at 28, fn. 8) that address timeliness under an inapposite federal rule regarding default *judgments* (FRCP 60) to suggest that five months was not "reasonable." Not only does the SEC again rely on federal rule analogs when they support the SEC's position, but the cases relied on by the SEC make clear that "[t]here is no hard and fast rule as to how much time is reasonable for the filing of a Rule 60(b)(6) motion" and that "courts have found periods of as little as a few months unreasonable, and have found periods of as long as three years reasonable." *Sudeikis v. Chicago Transit Auth.*, 774 F.2d 766, 769 (7th Cir. 1985); *Ashford v. Steuart*, 657 F.2d 1053, 1055 (9th Cir. 1981) ("[w]hat constitutes reasonable time depends upon the facts of each case, taking into consideration the interest in finality, the reason for delay, the practical ability of the litigant to learn earlier of the grounds relied upon, and [the consideration of] prejudice [if any] to other parties" (internal citations omitted). Further, this Circuit has not identified a specific benchmark for assessing what amount of time is "reasonable," but focuses on whether there is prejudice to the opposing party. *Salazar v. District of Columbia*, 633 F.3d 1110, 1119 (D.C. Cir. 2011). As discussed, *supra*, there is no prejudice here to the SEC.

[29] Indeed the Division – with whom Rapoport's counsel attempted to negotiate a settlement – did not even argue that Rapoport had failed to move with a reasonable time. JA 571-82; JA 697.

III. The Commission Abused Its Discretion When It Recklessly Imposed Sanctions On Rapoport That Are Not Supported By The Well-Pleaded Allegations In The OIP

Rapoport's Petition demonstrated that the Commission did not consider – "meaningfully" or otherwise – the baseless and disproportionate penalties imposed on Rapoport by the ALJ, which included a lifetime associational bar, an accounting and disgorgement of "ill-gotten" gains, and a $555,000 civil penalty (originally consisting of five maximum second-tier penalties for each year from 2003-2007, but later reduced to $315,000 due to a "mathematical error"). Instead, the Commission blindly adopted the deeply flawed reasoning by the ALJ, who ignored the absence of well-pleaded allegations against Rapoport with respect to: (i) 2003-2005 and (ii) second-tier penalties.

Imposing these penalties was a clear abuse of the SEC's discretion. The SEC claims (Opp. at 35) that it satisfied its obligation to "meaningfully" and "seriously" consider these penalties when it declared in the Decision – without reasoning, analysis or explanation of any kind – that it was "not unjust" for the ALJ to impose sanctions that "did not go beyond the allegations in the OIP." This Court requires considerably more (P. at 23-24), and the SEC cites no case, within or without this Circuit, to support the claim that the Decision provides a sufficient basis for barring Rapoport from the securities industry for life and imposing

$315,000 in civil penalties, plus disgorgement. *See, e.g.*, *Steadman v. SEC*, 503 F.2d 1126, 1139 (5th Cir. 1979).

A. The Sanctions Attributable To 2003-2005 Must Be Eliminated

Rapoport (P. at 27-29) explained that the well-pleaded allegations in the OIP do not support sanctions against Rapoport attributable to 2003, 2004, or 2005 (the "2003-2005 Sanctions"), and the SEC admits (Opp. at 36-37) that its *only* basis for the 2003-2005 Sanctions is two paragraphs in the OIP ("Paragraphs 1 and 9").[30] Because Paragraphs 1 and 9 are not "well-pleaded," however, these sanctions must be set aside. *See Adkins v. Teseo*, 180 F. Supp.2d 15, 17 (D.D.C. 2001) (defaulting defendant admits "only the well-pleaded allegations of the complaint"); *Mutaka Mwani v. Bin Ladin*, 244 F.R.D. 20, 23 (D.D.C. 2007) (allegations only taken as true after default if "well-pleaded").

Paragraphs 1 and 9 are conclusory and introductory allegations against multiple OIP Respondents that are not well-pleaded as to Rapoport for several reasons. *See* OIP ¶ 1 (generally alleging that *all six* respondents violated Section 15(a)) and OIP ¶ 9 (generally alleging that CI-Moscow *and* Rapoport violated Section 15(a)). *First*, Paragraphs 1 and 9 are *legal conclusions* that are not deemed admitted by default. *See DirecTV, Inc. v. Hoa Huynh*, 503 F.3d 847, 854 (9th Cir.

[30] The Commission (Opp. at 37) references paragraph 9 of the OIP as paragraph 8.

2007) (defaulting defendant "is not held . . . to admit conclusions of law," and allegations that "parrot" the relevant statutory language are not admitted by default).[31] *Second*, Paragraphs 1 and 9 cannot support a finding that Rapoport "indirectly" solicited investors through CI-New York from 2003-2005, because the OIP makes a more specific allegation (JA 29 ¶ 17) that Rapoport "controlled" CI-New York in 2006 and 2007 *only*.[32] *See Mutaka Mwani*, 244 F.R.D. at 23 (allegations "made indefinite or erroneous by other allegations in the same complaint" are not well-pleaded); *see also Trans World Airlines, Inc. v. Hughes*, 449 F.2d 51, 63 (2d Cir. 1971) (same). *Third*, Paragraphs 1 and 9 cannot support a finding that Rapoport "directly" solicited U.S. investors from 2003-2005, because there is *zero* evidence that Rapoport even communicated with a single U.S. investor from 2003-2005. *Mutaka Mwani*, 244 F.R.D. at 23 (allegations not "provable by legitimate evidence" are not well-pleaded).[33] The SEC does not (and

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[31] *See also Nishimatsu Constr. Co. v. Houston Nat'l Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975) ("The defendant is not held to admit facts that are not well-pleaded or to admit conclusions of law") *citing Thomson v. Wooster*, 114 U.S. 104, 113 (1884); *Wallace v. Fed. Emples. of United States Dist. Court*, 325 Fed. Appx. 96, 101 (3d Cir. 2009) ("a default admits only well-pleaded facts and not legal conclusions").

[32] This specific allegation comports with the OIP's specific allegations regarding Yenin, CI-New York's managing director, CFO, and FINOP who worked for CI-New York until returning to Moscow in "early 2006." JA 27 (¶7).

[33] *See also Pack v. United States*, 1996 U.S. Dist. LEXIS 1528, at *3-4 (E.D. Cal. 1996) ("default establishes the well-pleaded allegations of a complaint unless

cannot) claim that there is evidence of such a communication in the Opposition, because no such evidence exists.[34] *Fourth*, Paragraphs 1 and 9 are *indefinite* with respect to Rapoport's "direct" and "indirect" solicitation of investors because they fail to differentiate between the conduct of Rapoport and others. The SEC's fallback argument (Opp. at 38) – that there *are* well-pleaded allegations with respect to Rapoport's 2006-07 conduct – evinces the SEC's understanding that the 2003-2005 Sanctions are patently unsupportable.

As to 2003 specifically, the SEC concedes (Opp. at 37) that Rapoport cannot be liable for conduct prior to December 8, 2003, but argues that because a separate civil penalty may be assessed "for each such act or omission," the ALJ was not "forbidden" from imposing a $60,000 penalty on Rapoport for his "conduct occurring in the last three weeks of 2003." Accepting the SEC's implausible assertion that it can impose a limitless number of penalties for the ongoing violation of a single rule, the *only* support in the OIP for a penalty against Rapoport attributable to 2003 is the indefinite reference to conduct by Rapoport

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they are incapable of proof . . ."); *cf. Jackson*, 636 F. 2d at 835 ("modern courts are also reluctant to enter and enforce judgments unwarranted by the facts.").

[34] The Division lacks such evidence despite obtaining affidavits from two of Rapoport's cooperating co-respondents (Herlyn and Chekholko) and at least three different U.S. investors. Indeed, the Division's "evidence" reflects only two communications between Rapoport and a U.S. investor at all; both occurred in 2007. JA 920-21; JA 1082-83.

and others beginning in "about 2003" [35] in Paragraphs 1 and 9, which are not well-pleaded.

In the Decision, the Commission intentionally disregarded these arguments concerning the total lack of allegations and evidence to support for 2003-2005 Sanctions. Its order imposing $185,000 in penalties attributable to 2003, 2004 and 2005 was therefore not only an abuse of its discretion, but lacked substantial justification.[36]

B. The "Second-Tier" Civil Penalties Against Rapoport Must Be Eliminated For All Years

In response to Rapoport's argument (P. at 29-33) that ten words in the Decision was not "meaningful consideration" of $315,000 in maximum "second-tier" civil penalties, the SEC does not (Opp. at 38-41) – because it cannot – defend its consideration of these penalties in the Decision. Nor does the SEC dispute that when the ALJ "concluded" (Opp. at 39) that Rapoport's actions warranted "second-tier" penalties, the ALJ conflated Rapoport with Yenin, a registered

[35] The ALJ's initial decision with respect to CI-Moscow found that CI-New York's representatives began soliciting U.S. investors on behalf of CI-Moscow "by at least 2004." JA 472.

[36] Pursuant to the Equal Access to Justice Act, a party aggrieved by an agency decision that lacks substantial justification can recover "all fees and other expenses incurred in connection with that proceeding." 5 U.S.C. § 504

broker-dealer who held seven SEC licenses and was responsible for CI-New York's regulatory compliance.

Instead, the SEC argues (Opp. at 39-40) that its error, and the ALJ's error, should be excused because the ALJ "discussed" the conduct supporting "second-tier" penalties against Rapoport elsewhere in the Default Order, separate and apart from the ALJ's penalty analysis. That "discussion," however, merely recapitulates allegations in the OIP that do not support a finding of scienter,[37] and in any event, the SEC's after-the-fact reliance on these allegations is no substitute for the Commission's obligation to "explain" why the "necessary elements for such sanctions were satisfied." (P. at 29-30.)

The SEC argues (Opp. at 40-41) that "regardless of who shoulders the blame," Rapoport did not comply with the registration requirements for foreign broker-dealers. This misses the point completely. "Second-tier" civil penalties require a level of knowledge tantamount to fraud, and it is because the registration

[37] The OIP alleges (JA 28, ¶14) that "at all relevant times, Rapoport knew that any representative of CI-Moscow who solicited a U.S. investor" would have to register with the Commission. This allegation is false and not well-pleaded, and therefore does not support a finding that Rapoport violated Section 15(a) with scienter. Indeed, the paragraph immediately preceding (JA 28, ¶13) states that CI-Moscow representatives did *not* need to register if CI-New York maintained certain required books and records, and alleges that Yenin – not Rapoport – was advised of these record-keeping requirements. *Id.* The OIP does not allege that Rapoport knew that CI-New York and Yenin had not complied with their record-keeping obligations; that Rapoport even knew these requirements existed; or that Rapoport knew that *his* conduct required registration with the SEC.

requirements for foreign broker-dealers are so unknowable and arcane even to regulatory specialists – let alone a foreign broker like Rapoport – that Rapoport could not have deliberately or recklessly disregarded them.

Rapoport's Petition explained that even if there was a basis for imposing five maximum second-tier penalties on Rapoport totaling $315,000, a lifetime associational bar, and disgorgement – and there is not – these severe penalties are "not justified under the circumstances" and should be eliminated. (P. at 32-33.) The SEC erred by failing to consider these circumstances at all in the Decision,[38] and its belated attempts (Opp. at 41-42) to address them are unavailing.

The SEC does not dispute (Opp. at 41) that had CI-New York performed certain administrative functions, there would be *no Section 15(a) violation by Rapoport*.[39] The SEC asserts (Opp. at 42) that Rapoport violated a rule that is "keystone of the entire system of broker-dealer regulation,"[40] but is forced to

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[38] *See, e.g., Paz Sec. v. SEC*, 494 F.3d 1059 (D.C. Cir. 2007) (reversing sanctions where SEC failed to adequately explain bases for sanctions and "address certain mitigating factors" raised by the petitioners before it).

[39] The SEC does not dispute that Rapoport's conduct resulted in no losses or harm to, or complaints by, United States investors. That third-tier penalties are appropriate where conduct "resulted in *substantial* losses or created a significant risk of substantial losses" 15 U.S.C. § 78u-2(a)(3) (emphasis added) does not mean, as the SEC argues (Opp. at 41), that the lack of *any* losses at all is irrelevant to the SEC's sanctions analysis.

[40] The SEC places principal reliance (*see* D.C. Cir. Rule 28(a)(2)) on the unpublished disposition in *Roth v. SEC,* 22 F. 3d 1108, 1109 (D.C. Cir. 1994) for

concede that in June 2008, the SEC proposed *still-pending* changes to liberalize this "keystone" that would render Rapoport's conduct blameless. Indeed, under the Proposed Amendment, foreign broker-dealers would be permitted (as CI-Moscow is alleged to have done improperly) to maintain records and issue confirmations, and representatives of foreign broker-dealers would be permitted (as Rapoport is alleged to have done improperly in 2006 and 2007) to actively solicit U.S. investors by registering for service of process.[41]

In short, the SEC cannot justify why Rapoport's alleged violation of requirements that *it* has proposed eliminating and that *it* views as outdated and inconsistent with "ever-increasing market globalization"[42] warrant $315,000 in five maximum civil penalties, disgorgement, and a lifetime bar from the securities industry, especially where the SEC has no evidence that Rapoport even communicated with a U.S. investor from 2003-2005. To the extent the Default

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this irrelevant and mischaracterized proposition, notwithstanding that unpublished decisions may not be cited as precedent. *See* D.C. Cir. Rule 32.1(b)(1)(A)

[41] The SEC's claim (Opp. at 42) that the Proposed Amendment would retain the current record-keeping requirements is wrong. Under Proposed Rule 15a-6, "copies of all books and records, including confirmations and statements issued by the foreign broker or dealer," could be maintained "with the foreign broker-dealer, provided that the registered broker or dealer makes a reasonable determination that copies of any or all such books or records can be furnished promptly to the Commission, and promptly provides to the Commission any such books and records, upon request." Exchange Act Release No. 58047, "Proposed Rule on Exemption of Certain Foreign Brokers or Dealers." JA 813-14.

[42] JA 729-30.

Order is not set aside, Rapoport respectfully requests that these penalties be reduced or eliminated accordingly.

Respectfully submitted,

Dated: December 19, 2011

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32, I hereby certify that Final Reply Brief of Petitioner Dan Rapoport complies with the type-volume limitation because it is 6732 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii) and Circuit Rule 32(a)(2), and is written in Times New Roman 14-point font.

Dated: December 19, 2011

/s/ Michael A. Hanin
Michael A. Hanin

CERTIFICATE OF SERVICE

Pursuant to Federal Rule of Appellate Procedure 25(d)(2), I hereby certify that the Final Reply Brief of Petitioner Dan Rapoport was served on Respondent Securities and Exchange Commission via the Case Management/Electronic Case Filing system of the United States Court of Appeals, District of Columbia Circuit, which will send notice of such filing to the following registered CM/ECF users:

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Dated: December 19, 2011

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ADDENDUM

TABLE OF CONTENTS: STATUTES

Except for the following, all relevant statutes are contained in Petitioner's Opening Brief and Respondent's Opposition Brief

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STATUTES ADDENDUM

15 U.S.C. § 78aa provides in relevant part:

§ 78aa. Jurisdiction of offenses and suits

(a) In general. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title [15 USCS §§ 78a et seq.] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title [15 USCS §§ 78a et seq.] or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. In any action or proceeding instituted by the Commission under this title [15 USCS §§ 78a et seq.] in a United States district court for any judicial district, a subpoena issued to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing or trial may be served at any place within the United States. Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure shall not apply to a subpoena issued under the preceding sentence. Any suit or action to enforce any liability or duty created by this title [15 USCS §§ 78a et seq.] or rules and regulations thereunder, or to enjoin any violation of such title [15 USCS §§ 78a et seq.] or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of title 28, United States Code. No costs shall be assessed for or against the Commission in any proceeding under this title [15 USCS §§ 78a et seq.] brought by or against it in the Supreme Court or such other courts.

15 U.S.C. § 78y(a)(1) provides in relevant part:

§ 78y. Court review of orders and rules

(a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence.

(1) A person aggrieved by a final order of the Commission entered pursuant to this title [15 USCS §§ 78a et seq.] may obtain review of the order in the United

States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

5 U.S.C. § 504 provides in relevant part:

§ 504. Costs and fees of parties

(a)

(1) An agency that conducts an adversary adjudication shall award, to a prevailing party other than the United States, fees and other expenses incurred by that party in connection with that proceeding, unless the adjudicative officer of the agency finds that the position of the agency was substantially justified or that special circumstances make an award unjust. Whether or not the position of the agency was substantially justified shall be determined on the basis of the administrative record, as a whole, which is made in the adversary adjudication for which fees and other expenses are sought.