FINAL BRIEF

No. 06-1071

ORAL ARGUMENT SCHEDULED NOVEMBER 20, 2006

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

FOG CUTTER CAPITAL GROUP, INC.,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

A. PARTIES

All parties, intervenors, and amici appearing before the Commission and this Court are listed in the brief for the petitioners.

B. THE RULING UNDER REVIEW

On December 21, 2005, the Commission issued the order, *Fog Cutter Capital Group, Inc.*, Exchange Act Release No. 52993 (Dec. 21, 2005), that petitioner challenges here.

C. RELATED CASES

The case on review has not previously been before this, or any other, Court. Counsel is not aware of any related cases currently pending in this, or any other, Court.

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GLOSSARY

Board	Fog Cutter Capital Group, Inc.'s Board of Directors
Br. __	Petitioners' opening brief at page __.
Commission	Securities and Exchange Commission
Fog Cutter	Fog Cutter Capital Group, Inc.
GEMB	George Elkins Mortgage Banking Co.
J.A. __	Joint Appendix at page __.
Nasdaq	The Nasdaq National Market
Op. __	Opinion of the Commission at page __.
R. __	the administrative record at page __.
SRO	self-regulatory organization

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JURISDICTIONAL STATEMENT

The Securities and Exchange Commission ("Commission") had jurisdiction pursuant to Section 19(d)(2) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78s(d)(2), to consider the application of petitioner Fog Cutter Capital Group, Inc. ("Fog Cutter") to review the decision of NASD to delist Fog Cutter's securities from The Nasdaq National Market ("Nasdaq"). This Court has jurisdiction pursuant to Section 25(a)(1) of the Exchange Act, 15 U.S.C. 78y(a)(1),

over the petition, filed on February 17, 2006, seeking review of the Commission's December 21, 2005 order dismissing Fog Cutter's application for Commission review.

COUNTERSTATEMENT OF THE ISSUES

Whether the Commission's decision in reviewing, pursuant to Section 19(f) of the Exchange Act, NASD's delisting decision is supported by substantial evidence in the record and was not arbitrary, capricious, or an abuse of discretion.

STATUTES AND REGULATIONS

An Addendum to this brief sets forth Section 19(f) of the Exchange Act, 15 U.S.C. 78s(f), which governs the Commission's review of NASD's action. The Addendum to the petitioner's brief did not include this provision but otherwise contained all applicable statutes and regulations.

COUNTERSTATEMENT OF THE CASE

A. Nature of the Case

Fog Cutter petitions this Court to review the Commission's order dismissing its application for review of NASD's decision to delist its securities from Nasdaq. *See* Opinion of the Commission (Op. __), and Order Dismissing Review Proceeding (provided in Addendum to Petitioner's Brief). Applying Section 19(f) of the Exchange Act, 15 U.S.C. 78s(f), the Commission found, on an independent

review of the record, that the grounds for NASD's delisting of Fog Cutter's securities exist in fact, NASD's decision was in accordance with its rules, and these rules were applied in a manner consistent with the Exchange Act. Op. 7-12.

Fog Cutter's delisting was based on the following facts, among others: On June 2, 2004, the Fog Cutter Board of Directors gave Andrew Wiederhorn—the company's majority shareholder, Chief Executive Officer ("CEO") and Chairman of the Board—the titles of Co-CEO and Co-Chairman of the Board. R. 103; J.A. 28. The Board also approved a $2 million bonus for Wiederhorn, and agreed to continue paying him his full salary, bonuses, and benefits for the next 18 months. R. 110; J.A. 35. The Board took these actions on the day before Wiederhorn was to plead guilty to two felony charges in United States District Court. R. 110-11; J.A. 35-36. Wiederhorn's $2 million bonus was to pay for the criminal restitution that he would agree to the next day in his guilty plea. R. 890; J.A. 327. The Board apparently intended that Wiederhorn would be serving his next 18 months as Co-CEO (a position that, under the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7201 *et seq.*, would require him to certify the company's quarterly and annual reports) and receiving his full salary, bonuses, and benefits—from federal prison. R. 107-10; J.A. 32-35. The Commission found that these factors, among others, "led NASD to conclude that Fog Cutter, with Wiederhorn in control under only

nominal Board supervision, was an issuer that presented inappropriate non-market risk to public investors and, consequently, should be delisted." Op. 10.

In addition to finding that the grounds for NASD's decision exist in fact, the Commission concluded that, in delisting Fog Cutter's securities, NASD's decision was consistent with NASD Marketplace Rules 4300 and 4330, which give NASD broad discretion to delete an issuer's securities from Nasdaq to protect the public interest. The Commission also concluded that these rules were applied in a manner consistent with the Exchange Act. The Commission thus sustained NASD's decision and dismissed Fog Cutter's petition for review. *Id.* at 11.

B. The Self-Regulatory Organization Regulatory Scheme

NASD is a registered "national securities association" under Section 15A of the Exchange Act, 15 U.S.C. 78o-3, responsible for regulation of the over-the-counter securities market. *See, e.g., NASD v. SEC*, 431 F.3d 803, 804 (D.C. Cir. 2006); *Domestic Sec., Inc. v. SEC*, 333 F.3d 239, 242 (D.C. Cir. 2003). Since 1971, NASD has operated Nasdaq, an electronic automated securities quotation system for over-the-counter securities. [1/] *See Domestic Sec.*, 333 F.3d at 242.

[1/] We note, although not relevant to the issues on appeal, that on January 13, 2006, the Commission approved Nasdaq's application to be registered as a national securities exchange (called The Nasdaq Stock Market LLC) pursuant to Section 6 of the Exchange Act, 15 U.S.C. 78f. *See* Exchange Act Release No. 53128 (Jan. 13, 2006), 71 Fed. Reg. 3,550 (Jan. 23, 2006).

To be registered as a self-regulatory organization ("SRO"), a national securities association must have rules that are designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. *See* Section 15A(b)(6) of the Exchange Act, 15 U.S.C. 78o-3(b)(6). Accordingly, as the Commission has pointed out, "NASD is empowered to protect the integrity of the market it is charged with maintaining" by, among other things, having the "discretionary authority to exclude [or remove] an issuer from Nasdaq or impose additional or more stringent conditions for [initial or continued] inclusion in Nasdaq" even where the issuer otherwise meets NASD's enumerated criteria for inclusion (*e.g*, minimum number and value of publicly-held shares, minimum bid price per share). *Air L.A., Inc.*, Exchange Act Release No. 34491, 1994 WL 413098, at *2 (Aug. 3, 1994). In particular, at the time of NASD's decision here, NASD Marketplace Rule 4300 provided that:

> [Nasdaq] stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process. Nasdaq issuers . . . by being included in Nasdaq, are publicly recognized as sharing these important objectives. . . .
>
> Nasdaq, therefore, . . . will exercise broad discretionary authority over the initial and continued inclusion of securities in Nasdaq in order to maintain the quality and public confidence in its

> market. Under such broad discretion . . . Nasdaq may deny initial inclusion or apply additional or more stringent criteria for the initial or continued inclusion of particular securities or suspend or terminate the inclusion of particular securities based on any event, condition, or circumstance which exists or occurs that makes initial or continued inclusion of the securities in Nasdaq inadvisable or unwarranted in the opinion of Nasdaq, even though the securities meet all enumerated criteria for initial or continued inclusion in Nasdaq.

NASD's Marketplace Rule 4330(a)(3) further specified that Nasdaq may make such a determination to deny initial or continued inclusion of an otherwise qualified security if "Nasdaq deems it necessary to prevent fraudulent and manipulative acts or practices, to promote just and equitable principles of trade, or to protect investors and the public interest." [2/]

In approving these rules, pursuant to Section 19(b) of the Exchange Act, 15 U.S.C. 78s(b), the Commission stated that "inclusion of a security for trading in Nasdaq, like listing on an exchange, should not depend solely on meeting quantitative criteria, but should also entail an element of judgment given the expectations of investors and the imprimatur of listing on a particular market." Exchange Act Release No. 34151 (June 3, 1994), 59 Fed. Reg. 29,843, 29,845 (June 9, 1994). The Commission also found that allowing NASD discretionary

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[2/] Although NASD's rules were subsequently amended, *see* Exchange Act Release No. 52342 (Aug. 26, 2005), 70 Fed. Reg. 52,456 (Sept. 2, 2005), these amendments made no substantive changes to Marketplace Rules 4300 and 4330. *See* Op. 2 n.1.

authority to exclude an issuer from Nasdaq "provides investors greater assurance that the risk associated with investing in Nasdaq is market risk rather than the risk that the promoter or other persons exercising substantial influence over the issuer is acting in an illegal manner." *Id.*

An initial decision to delist an issuer's securities is made by the staff in the Nasdaq Listing Qualifications Department, which notifies the issuer of its determination to delist. *See* NASD Marketplace Rules 4330(b), 4815. The issuer may request a hearing with a Nasdaq Listing Qualifications Panel; such a request will stay the staff's decision while the Panel considers the matter. *See* NASD Marketplace Rule 4820. The Panel is composed of at least two independent persons (*i.e.*, they cannot be employees of NASD, Nasdaq, or any other NASD subsidiary) designated by the Nasdaq Board of Directors. *See* NASD Marketplace Rule 4830(a). The issuer may file a written submission and submit additional evidence to the Panel and "may make such presentation as it deems appropriate" at the hearing, including having officers, directors, or other persons appear for questioning. *See* NASD Marketplace Rules 4820(b), 4830(b). After the hearing, and in consideration of any written submissions or evidence in the record, the Panel issues a written decision. A decision that delisting is warranted must describe the specific grounds for this determination and identify the "quantitative

standard or qualitative consideration" that the issuer has failed to satisfy. *See* NASD Marketplace Rule 4830(b)-(c).

The Panel's decision may be reviewed by the Nasdaq Listing and Hearing Review Council, a committee appointed by the Nasdaq Board of Directors whose responsibilities include the consideration of determinations to limit or prohibit the listing of an issuer's securities, at the issuer's request or on the Listing Council's own initiative. *See* NASD Marketplace Rule 4840(a), (c). The Listing Council may issue a decision based on the written record, hold additional hearings, or recommend that the NASD Board of Governors consider the matter. *See* NASD Marketplace Rule 4840(d). The Listing Council's written decision must "describe the specific grounds for [its] decision" and, if it determines to delist, must "identify the quantitative standard or qualitative consideration" that the issuer failed to satisfy; the Listing Council may affirm, modify, or reverse the Panel's decision, or refer the matter to Nasdaq staff or the Panel for further consideration. *See* NASD Marketplace Rule 4840(e).

Solely at its discretion, the NASD Board may call a Listing Council decision for review. *See* NASD Marketplace Rule 4850(a). If the Board declines to review a Listing Council decision or withdraws its call for review, the Listing

Council's decision represents NASD's final action. *See* NASD Marketplace Rule 4850(d).

An NASD decision to deny initial listing or to delist a listed security is subject to review by the Commission pursuant to Section 19(d)(2) of the Exchange Act, 15 U.S.C. 78s(d)(2), as a final SRO action "prohibit[ing] or limit[ing] any person in respect to access to services offered by such organization . . . ." Section 19(d)(1), 15 U.S.C. 78s(d)(1). In reviewing an NASD decision to delist an issuer's securities from Nasdaq, the Commission "shall dismiss the [review] proceeding" if, on an independent review of the record, it finds (i) "that the specific grounds" for NASD's listing decision "exist in fact," (ii) that NASD's decision "is in accordance with the rules of the [SRO]," and (iii) that "such rules are, and were applied in a manner, consistent with the purposes of [the Exchange Act]." Section 19(f) of the Exchange Act, 15 U.S.C. 78s(f). On the other hand, if the Commission "does not make any such finding or if it finds that" NASD's decision "imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter," the Commission "shall set aside the action of [NASD] and require" NASD to list the security on Nasdaq. *Id.* [3/]

[3/] As the Commission recognized below (Op. 7 n.13), the company did not argue, and the record did not suggest, that NASD's decision to delist Fog Cutter's securities imposes an undue burden on competition.

C. Statement of the Facts

1. Background

According to its public filings, Fog Cutter operates a restaurant business, conducts commercial mortgage lending and brokerage activities, makes real estate investments, and seeks to acquire controlling interests in "underperforming or undervalued operating businesses . . . ." R. 117; J.A. 42. Wiederhorn, together with family members, owns approximately 53 percent of the company's shares. R. 149-51; J.A. 74-76. Wiederhorn held the positions of CEO and Chairman of the Board since the company's inception. R. 107; J.A. 32. The company claims that Wiederhorn was "central to the success of [Fog Cutter]" and was "an indispensable CEO" (R. 882; J.A. 319), and that Wiederhorn was the "sole officer of Fog Cutter . . . familiar with each of Fog Cutter's diverse business lines . . . ." R. 241; J.A. 145. The members of Fog Cutter's seven-member Board, although including five members who met the definition of "independent" under NASD Marketplace Rule 4200(a)(15), all had family, business, or social ties to Wiederhorn during the relevant period. R. 38, 229-30, 820, 849; J.A. 22, 133-34, 287.

2. The U.S. Attorney's Office Begins Investigating Wiederhorn for Possible Felonies Unrelated to Fog Cutter; in Response, the Fog Cutter Board Amends Wiederhorn's Employment Agreement To Remove the Option of Firing Wiederhorn for a Felony Conviction Unrelated to Fog Cutter.

In March 2001, Wiederhorn was informed by the U.S. Attorney's Office for the District of Oregon that he was the target of a grand jury investigation into the collapse of Capital Consultants, LLC (referred to below as "CCI"), an employee-benefit-fund adviser with which Wiederhorn's previous company had done business. R. 1235-36; J.A. 472-73.

The company admittedly was aware of Wiederhorn's status as a target of the grand jury's investigation for crimes unrelated to Fog Cutter and disclosed this fact to investors in its public filings as early as May 2001. *See* Br. 10 and n.1. Nonetheless, at Wiederhorn's request (R. 719, 721; J.A. 229, 273), on August 11, 2003, the Board approved an amended employment agreement for Wiederhorn that removed the Board's ability to fire him "for cause" in the event he were convicted of a felony unrelated to Fog Cutter. R. 245; J.A. 149. Specifically, the Board amended the definition of "for cause" termination in Wiederhorn's employment agreement—which previously had granted the Board the discretion to terminate Wiederhorn "for cause" upon his conviction of any "felony (other than a felony

involving a traffic offense)"—to grant the Board the discretion to terminate Wiederhorn "for cause" upon conviction only of a "felony (other than a felony involving a traffic offense) involving [Fog Cutter]." R. 316; J.A. 211. Under Wiederhorn's amended employment agreement, if Fog Cutter terminated Wiederhorn *without* cause, the company, within ten days, would owe him, among other things, a lump sum payment that Fog Cutter estimated would total over $6 million, consisting of an amount equal to three times his annual salary plus three times his largest annual bonus payment. R. 317-19; J.A. 212-14.

3. On the Eve of His Guilty Pleas, the Board Agrees To Retain Wiederhorn While in Prison, Pay Wiederhorn His Full Salary, Bonuses and Benefits, and To Pay Wiederhorn's $2 Million Restitution.

In early 2004, Wiederhorn, who had been indicted and was awaiting trial, informed the Fog Cutter Board that he was prepared to fight the charges against him. Br. 12. Wiederhorn claimed that he would not agree to forgo trial by pleading guilty unless he could obtain what the company characterizes as "satisfactory financial terms . . . ." Br. 19. The company was concerned that allowing Wiederhorn to proceed to trial would result in negative publicity and distraction from business. Br. 12. The company claimed to have considered terminating Wiederhorn—indeed, the company represented to Nasdaq that counsel

at one point had convinced Wiederhorn to resign (R. 883; J.A. 320)—but determined that he was too important to Fog Cutter's business to do so. According to the company, it was aware that the two felonies to which Wiederhorn was to plead guilty did not involve his actions while with Fog Cutter and that one of Wiederhorn's guilty pleas, to a violation of an illegal gratuity statute, involved "a general intent crime for which no intent for a *quid pro quo* must be proven." R. 108; J.A. 33. The company also claimed to be concerned with losing its fifty-one percent control over a subsidiary, George Elkins Mortgage Banking Co., Inc. ("GEMB"). R. 109; J.A. 34. Under Fog Cutter's stock-purchase agreement with GEMB, the GEMB minority owners have the right to repurchase Fog Cutter's interest in GEMB at a "fire-sale price" (Br. 13) if, among other things, Wiederhorn is neither "serving on [Fog Cutter's] board of directors nor as its Chief Executive Officer." R. 1091-92; J.A. 435-36. Before Nasdaq, the company cited the desire "to avoid that windfall to the 49 percent shareholders" as being "our reason" for not terminating Wiederhorn. R. 886; J.A. 323.

Thus, on June 2, 2004, the Board entered into a Leave of Absence Agreement with Wiederhorn, which allowed him to retain the positions of Co-CEO and Co-Chairman of Fog Cutter and to receive his annual salary (which was $350,000), bonuses, and benefits while serving his prison sentence. R. 102-14;

J.A. 27-39. Wiederhorn's father-in-law was to serve as the other Co-CEO and Co-Chairman while Wiederhorn was serving his sentence. R. 38, 103; J.A. 22, 28. In addition, the company agreed to pay Wiederhorn a "leave of absence" payment of $2 million, in consideration of his "good will, cooperation, and continuing assistance, and in recognition of Mr. Wiederhorn's past service to the Company, to help avoid litigation and for other reasons." R. 110, 1236; J.A. 35, 473. Although the company stated that it did not "like the idea of helping [Wiederhorn] pay a criminal penalty" and admitted that it knew "full well that it would be a controversial decision" (R. 900; J.A. 337), Fog Cutter knew that Wiederhorn would use this money to pay the $2 million in restitution under the plea agreement: "[W]e made the decision as a Board to pay him that extra $2 million to enable him to make [the] $2 million restitutionary [sic] payment to the government . . . ." R. 890; J.A. 327. In total, the company spent $4,750,000 on "leave of absence expense" during a period when it reported a $3,932,000 net loss. R. 1300; J.A. 523. Indeed, the company attributed higher-than-normal operating expenses for that period to the "leave of absence" payments for Wiederhorn. R. 269; J.A. 173.

4. Despite Wiederhorn's Guilty Pleas and 18-Month Prison Sentence, Fog Cutter Plans on Having Wiederhorn Discharge His Duties as Co-CEO from His Prison Cell.

The next day, June 3, 2004, Wiederhorn pleaded guilty to paying an illegal gratuity to an investment adviser to an employee benefit plan in violation of 18 U.S.C. 1954 and to filing a false tax return in violation of 26 U.S.C. 7206(1). [4/] The court sentenced him to eighteen months imprisonment and required him to pay a $25,000 fine and $2 million in restitution to the receiver for CCI. R. 1256; J.A. 485.

The following day, June 4, 2004, the company disclosed publicly the terms of Wiederhorn's plea agreement and sentence as well as the Board's decisions to retain and pay Wiederhorn during his period of incarceration. R. 102-03; J.A. 27-28. This was the first time that the public—including the U.S. Attorney

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[4/] 18 U.S.C. 1954 makes it illegal for "any person [to] directly or indirectly give[] or offer[], or promise[] to give or offer, any fee, kickback, commission, gift, loan, money, or thing of value prohibited by this section" to "a person who . . . provides benefit plan services to such plan . . . because of . . . any of the actions, decisions, or other duties relating to any question or matter concerning such plan . . . ." 26 U.S.C. 7206 provides, in part, that "[a]ny person who . . . [w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter . . . shall be guilty of a felony . . . ."

prosecuting Wiederhorn—was informed that Fog Cutter had agreed to pay Wiederhorn's court-ordered restitution. The U.S. Attorney reacted:

> I actually learned about it first thing in the morning . . . the day after the plea, and it was like a bucket of cold water in the face. . . . It's almost as if [Wiederhorn] was rewarded as a result of the plea agreement here. I simply know of no precedent for that.

R. 857; J.A. 294.

At that time, it was apparently the Board's intention to have Wiederhorn act as Co-CEO from his prison cell. On August, 13, 2004, however, after having been informed by the Federal Bureau of Prisons that Wiederhorn would not be allowed to conduct business as an inmate, Fog Cutter for the first time realized that Wiederhorn would be unable to carry out the duties of a CEO under Sarbanes-Oxley while incarcerated and changed Wiederhorn's title from Co-CEO to Chief Strategy Officer. R. 225; J.A. 129. Wiederhorn, however, was able to retain his title as Co-Chairman. He returned to his positions with the company as CEO and Chairman in November 2005 after his release from jail and a work-release program. Op. 6 n.12.

D. Proceedings Below

1. NASD

After reviewing Fog Cutter's June 4, 2004 Form 8-K—which first informed the public of Wiederhorn's guilty pleas and the Board's agreement to his monetary demands—the staff in the Nasdaq Listings and Qualifications Department began investigating whether Fog Cutter's securities should remain listed on Nasdaq. On July 20, 2004, the Nasdaq staff concluded its investigation and informed Fog Cutter that, on July 29, 2004, its securities would be delisted from Nasdaq under NASD Marketplace Rules 4300 and 4330(a)(3) based on public interest concerns. R. 188-93; J.A. 113-18. Specifically, Nasdaq staff concluded that it was contrary to the public interest for Fog Cutter to remain listed on Nasdaq with a convicted felon exercising substantial influence over the company while incarcerated and in light of the Fog Cutter Board's actions in (i) renegotiating Wiederhorn's employment agreement, (ii) agreeing to pay Wiederhorn while in prison, (iii) paying his court-ordered restitution, and (iv) agreeing to retain him as Co-CEO and Co-Chairman during his imprisonment. R. 192-93; J.A. 117-18.

Fog Cutter appealed the staff's determination to the Listing Qualifications Panel, which, after conducting a hearing and receiving submissions from the company and Nasdaq staff, issued a decision agreeing with the staff's

determination that the public interest required that Fog Cutter's securities be delisted under Marketplace Rules 4300 and 4330(a)(3). R. 999; J.A. 379.

Fog Cutter appealed the Panel's decision to the Nasdaq Listing and Hearing Review Council. The Listing Council issued a decision affirming the Panel's decision to delist Fog Cutter's securities based on public interest concerns under NASD Marketplace Rules 4300 and 4330(a)(3). R. 1254-61; J.A. 483-90. The Listing Council considered Fog Cutter's stated reasons for the Board's actions, specifically noting that it had "taken into account the difficulties and pressures faced by Wiederhorn, the Board and the Company which were created by the government investigation and resulting plea agreement." R. 1260; J.A. 489. The Listing Council, however, concluded that the facts regarding the Board's actions "provide grounds for denying the Company's request for continued listing in order to protect the quality of and public confidence in The Nasdaq Stock Market, and to protect investors and the public interest." R. 1260-61; J.A. 489-90. In particular, the Listing Council "agree[d] with the Panel's concern that Wiederhorn . . . continues to exert influence and control over the Company's affairs . . . while incarcerated." R. 1260; J.A. 489. The Listing Council also found "incredulous" the Board's renegotiating Wiederhorn's employment agreement to effectively insulate him from being terminated for cause in the event he were convicted for a

felony arising from the CCI investigation. R. 1260; J.A. 489. Finally, the Listing Council found the Board's decision to pay Wiederhorn $2 million an "unconscionable" and "transparent attempt to pay Wiederhorn's court-ordered restitution related to his guilty pleas." R. 1260; J.A. 489.

The NASD Board did not call the matter for review at its next meeting. R. 1267-69; J.A. 491-93. Pursuant to NASD Marketplace Rule 4850, the Listing Council's decision thus became NASD's final action in this matter.

2. The Commission

Fog Cutter filed with the Commission an Application for Review of NASD's final action. R. 1271-84; J.A. 494-507. After an independent review of the record and in light of Fog Cutter's and NASD's submissions, the Commission dismissed Fog Cutter's application for review.

After reciting the facts of the case, the Commission set forth the standard governing its review of NASD's delisting decision: "Under Section 19(f), we will dismiss Fog Cutter's appeal if we find that 'the specific grounds on which such denial . . . is based exist in fact, that such denial . . . is in accordance with the rules of [NASD], and that such rules are, and were applied in a manner, consistent with the purposes of [the Exchange Act].'" Op. 6-7 (quoting 15 U.S.C. 78s(f)). The Commission noted that, under Marketplace Rules 4300 and 4330, NASD has the

discretion to apply additional or more stringent criteria to issuers to, among other things, protect investors and the public interest. *Id.* at 7. As the Commission recognized, "[w]e have stated that 'inclusion of a security . . . entail[s] an element of judgment given the expectations of investors and the imprimatur of listing on a particular market.'" *Id.* at 11 (quoting *DHB Capital Group*, 52 S.E.C. 740, 744 (1996)).

The Commission noted that Fog Cutter did not dispute the underlying factual grounds for NASD's decision to delist its securities—the facts surrounding Wiederhorn's guilty pleas and the actions of Fog Cutter's Board in regard to those pleas. *Id.* at 7. Rather, Fog Cutter disputed that these facts supported NASD's conclusion that Fog Cutter's continued listing on Nasdaq was contrary to the public interest. *Id.* The Commission rejected Fog Cutter's arguments and found that the grounds for NASD's delisting of Fog Cutter's securities exist in fact, NASD's decision was in accordance with NASD rules, and these rules were applied in a manner consistent with the Exchange Act. The Commission summarized NASD's decision as follows:

> NASD made clear the bases for its conclusion that the public interest required delisting of Fog Cutter: Wiederhorn's guilty plea to two felonies; his continuing influence over the company notwithstanding his imprisonment; the negotiation of the Amended Employment Agreement; the agreement to pay $2 million to cover the cost of

> court-order restitution in addition to the other terms of the Leave Agreement; and Fog Cutter's intention to have Wiederhorn act as CEO while incarcerated. These factors led NASD to conclude that Fog Cutter, with Wiederhorn in control under only nominal Board supervision, was an issuer that presented inappropriate non-market risk to public investors and, consequently, should be delisted.

Op. 10. The Commission thus recognized NASD's legitimate concern that Wiederhorn, as a convicted felon, intended to continue to exercise influence and control over Fog Cutter's business even while incarcerated, without any limitations placed on him by Fog Cutter's Board. *Id.* at 8.

The Commission relied on *JJFN Services, Inc.*, 53 S.E.C. 335 (1997), in which the Commission upheld NASD's refusal to list an issuer's securities based on the prior conviction of a controlling person who had pled guilty to, among other charges, filing a false tax return in violation of 26 U.S.C. 7206(1). Op. 8. The Commission rejected Fog Cutter's attempt to distinguish *JJFN* on the basis that the controlling person there was convicted for filing a false tax return in connection with another business while Wiederhorn's tax conviction pertained to his personal return: "The wrong committed by an untruthful taxpayer is telling a falsehood to an agency that relies upon truthful reporting of economic activity" and "is not altered by the circumstance that the falsehood was uttered . . . on his personal return instead of on a business return." *Id.*

The Commission also rejected Fog Cutter's attempt to distinguish *JJFN* based on the actions of Fog Cutter's Board, finding that "th[is] distinction aggravates, rather than lessens, the concerns raised by NASD with respect to Fog Cutter because the actions of Fog Cutter's Board were part of the problem." *Id.* at 9. Specifically, the Commission pointed out that the Board agreed to amend Wiederhorn's employment agreement "to prevent his termination for cause in the anticipated event that he might subsequently be convicted of crimes not involving Fog Cutter," and then, "knowing that Wiederhorn was going to plead guilty to the felony charges against him," agreed to retain Wiederhorn as Co-CEO and Co-Chairman and pay him his full compensation during his incarceration, and "indirectly paid the restitution imposed on Wiederhorn as part of his sentence." *Id.*

The Commission likewise rejected Fog Cutter's attempts to minimize Wiederhorn's felony convictions, noting that "we believe the sentence of eighteen months imprisonment (fourteen of which were served), payment of a $25,000 fine, and payment of $2 million in restitution make clear the seriousness of the offenses." *Id.* at 7. The Commission was unpersuaded by Fog Cutter's assertion that one of the crimes Wiederhorn pled guilty to violating did not involve what the company referred to as "criminal" intent; the Commission pointed out that "Fog

Cutter does not suggest that filing a false tax return does not require intent." *Id.* at 7 n.16. The Commission also rejected Fog Cutter's argument that Wiederhorn acted with the advice of professionals, noting that "we will not permit collateral attack on Wiederhorn's convictions." *Id.*

The Commission found unpersuasive Fog Cutter's argument that the Board had sound business reasons for the decisions it made, stating that "[t]he issue here . . . is not the Board's business judgment but, rather, the public interest." *Id.* at 11. In particular, the Commission noted, "[l]isting a security on a market creates expectations among investors that listed companies meet basic standards of corporate governance and financial soundness," and the risk to investors in investing in a listed security should be "market risk rather than the risk that the promoter or other person exercising substantial influence over the issuer is acting in an illegal manner." *Id.* The Commission also agreed with NASD's conclusion that, in the exercise of its "business judgment," the Board placed Wiederhorn's interests above those of the shareholders, as evidenced in part by the fact that the expense to Fog Cutter for Wiederhorn's "leave of absence" payments totaled $4,750,000 during a period wherein Fog Cutter reported a net loss of $3,932,000. *Id.* Along the same lines, the Commission questioned Fog Cutter's suggestion that, by retaining Wiederhorn and granting him the "leave of absence"

compensation package, the company was able to "avoid wrongful-termination litigation with Wiederhorn." *Id.* at 9. As the Commission stated, Wiederhorn's litigation threat only became credible because of "the Board's limitation of its authority to terminate Wiederhorn for cause under the Amended Employment Agreement . . . . " *Id.*

Finally, the Commission rejected Fog Cutter's argument that delisting its securities was inconsistent with the treatment of two other companies whose securities were not delisted. *Id.* at 10. Citing, *inter alia*, *Butz v. Glover Livestock Comm'n Corp.*, 411 U.S. 182, 187 (1973), the Commission stated that "each case is to be decided on its own facts and circumstances, and it is not appropriate to compare them." Op. 11. The Commission also found that Fog Cutter mistakenly relied on registration revocation cases under Section 12(j) of the Exchange Act, such as *e-Smart Technologies, Inc.*, 84 SEC Dkt. 2979 (Feb. 3, 2005). The Commission found these cases to be inapposite since the revocation of an issuer's registration means that those securities may not be traded publicly on any market or exchange absent an exemption. *Id.* 11 n.31. Here, by contrast, Fog Cutter's

stock continues to be traded publicly—just not on Nasdaq—as the company's stock is quoted on the Pink Sheets. *Id.* [5/]

STANDARD OF REVIEW

In reviewing a Commission order, Commission findings of fact are conclusive "if supported by substantial evidence." Section 25(a)(4) of the Exchange Act, 15 U.S.C. 78y(a)(4). Substantial evidence "does not mean a large or considerable amount of evidence, but rather such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Pierce v. Underwood*, 487 U.S. 552, 565 (1988) (citation omitted). The Commission's legal conclusions in applying Section 19(f) of the Exchange Act are reviewed for arbitrariness, capriciousness, or abuse of discretion. *See Exchange Serv., Inc. v. SEC*, 797 F.2d 188, 190-91 (4th Cir. 1986).

[5/] Pink Sheets LLC operates an Internet-based real time electronic quotation service that displays quotes of broker-dealers for securities traded in the over-the-counter market (i.e., securities that are not listed on a U.S. exchange or Nasdaq). Broker-dealers who buy and sell over-the-counter securities can use the Pink Sheets to publish their bid and/or ask quotations for these securities. *See* http://www.sec.gov/answers/pink.htm.

SUMMARY OF ARGUMENT

The Commission's decision dismissing Fog Cutter's application to review NASD's delisting decision is supported by substantial evidence in the record and was not arbitrary, capricious, or an abuse of discretion. The Commission applied the correct legal standard, finding that the grounds for NASD's decision—regarding Wiederhorn's convictions and the Fog Cutter Board's decisions to retain him as Co-CEO during his incarceration and to capitulate to his financial demands—exist in fact, that the decision to delist Fog Cutter's securities in the public interest was in accordance with NASD rules, and that NASD applied its rules in a manner consistent with the Exchange Act.

Fog Cutter's arguments are without merit. Although the Commission reviews NASD's decisions to delist pursuant to Section 19(f) of the Exchange Act, Fog Cutter ignores this governing legal standard. In particular, Fog Cutter's principal argument—that the Commission failed to adequately explain why it chose the "ultimate" remedy in delisting Fog Cutter's securities—ignores the fact that under Section 19(f) the Commission may not order a lesser remedy than delisting. Moreover, Fog Cutter bases its arguments on inapposite standards governing Commission review of SRO disciplinary proceedings under Section

19(e) of the Exchange Act and Commission proceedings to revoke an issuer's registration pursuant to Section 12(j).

Aside from arguing the wrong legal standard, Fog Cutter's substantive arguments—based in large part on a recitation of Fog Cutter's purported business reasons for agreeing to retain Wiederhorn and yielding to his financial demands —do not demonstrate either that the Commission's factual findings lack record support or that the Commission abused its discretion in dismissing Fog Cutter's application for review. As the Commission aptly found, "[t]he issue here . . . is not the Board's business judgment but, rather, the public interest." Op. 11. In any event, to accept Fog Cutter's claim that its Board made reasonable business decisions would require disregarding the Commission's factual finding, supported by ample evidence in the record, that Fog Cutter's Board was concerned more with Wiederhorn's financial needs than with protecting the interests of Fog Cutter's shareholders.

Fog Cutter's remaining argument faults the Commission for failing to compare this case to two other instances in which delisting proceedings were *not* brought. The Commission correctly noted that whether NASD's decision is justified depends on the facts and circumstances of this case, and it is not appropriate to compare them to other cases. The Commission thus declined to

compare this case to cases that were not even brought. In effect, Fog Cutter is arguing that it was a victim of selective prosecution. This argument fails because Fog Cutter cannot establish that the decision to delist its securities was based on a suspect classification or a desire to prevent the exercise of a constitutionally-protected right.

There is also no merit to Fog Cutter's reliance on *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1112-13 (D.C. Cir. 1988), where, in remanding on other grounds, this Court directed the Commission to address a company's claim that it was "singled out for disproportionately harsh treatment" as part of a "*systemic pattern of disparate treatment* . . . ." Fog Cutter has not demonstrated that it has been singled-out for harsh treatment as part of a systemic pattern.

ARGUMENT

THE COMMISSION'S DECISION TO DISMISS THIS PROCEEDING PURSUANT TO SECTION 19(f) OF THE EXCHANGE ACT IS SUPPORTED BY SUBSTANTIAL EVIDENCE IN THE RECORD AND WAS NOT ARBITRARY, CAPRICIOUS, OR AN ABUSE OF DISCRETION.

A. Section 19(f), which Petitioners Fail To Cite, Provides the Legal Standard Governing the Commission's Review of an NASD Delisting Decision.

Fog Cutter criticizes (Br. 30-31) the Commission's opinion for failing to provide an explanation for why the "ultimate sanction" of delisting was necessary.

In particular, Fog Cutter contends (Br. 29-31) that the Commission failed to satisfy the standard from cases such as *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005), which held that the Commission failed to articulate why it upheld a particular sanction, in lieu of a more lenient sanction, in reviewing, pursuant to Section 19(e) of the Exchange Act, an exchange's disciplinary proceeding against a member.

Fog Cutter ignores the controlling legal standard. NASD's decision to deny initial listing or to delist a listed security is not governed by Section 19(e) of the Exchange Act. Under Section 19(e)(2), the Commission reviews a sanction imposed in an SRO disciplinary proceeding for whether the sanction was excessive or oppressive or a burden on competition. 15 U.S.C. 78s(e)(2). If the Commission finds the sanction to be excessive, oppressive or a burden on competition, the Commission "may cancel, reduce, or require the remission of such sanction." *Id.* In contrast, under Section 19(f), which governs the Commission's review here, the Commission may either dismiss the proceeding—thus letting NASD's listing decision stand—or set aside the decision

and order NASD to allow the issuer's securities to be listed on Nasdaq. [6/] The Commission may not order a lesser remedy than delisting.

This is consistent with the manner in which the Exchange Act, in Section 12(d), 15 U.S.C. 78l(d), deals with delistings from securities exchanges. Section 12(d) of the Act provides that a security registered with a national securities exchange "may be withdrawn or stricken from listing and registration in accordance with the rules of the exchange and, upon such terms as the Commission may deem necessary to impose for the protection of investors, upon application by the issuer or the exchange to the Commission." *See Atlas Tack Corp. v. NYSE*, 246 F.2d 311, 316 (1st Cir. 1957) (holding that it is "mandatory upon the Commission to grant applications for delisting if the rules of the exchange have been followed"). Before passage of the Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975), in which Section 19(f) was adopted, the Commission applied the 12(d) standard (as supplemented by Commission rule to include an inquiry into whether the "specific grounds on which such action is based exist in fact") to review an NASD decision to delist an

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[6/] The Commission may also, without reaching the merits, remand to NASD for further explanation of NASD's decision. *See, e.g., Eagle Supply Group, Inc.*, 53 S.E.C. 480 (1998).

issuer's securities from Nasdaq. *See Tassaway, Inc.*, 45 S.E.C. 706, 709-10 (1975) ("we are not at liberty to substitute our discretion for that of the [NASD]").

The pertinent question, then, is whether substantial evidence supports the Commission's conclusion that the grounds for NASD's decision exist in fact and whether the Commission abused its discretion in finding that NASD's decision is in accordance with its rules and that these rules were applied in a manner consistent with the Exchange Act.

B. The Commission's Application of Section 19(f) Was Correct.

1. Substantial Evidence Supports the Commission's Finding that the Grounds for NASD's Decision Exist in Fact.

The Commission found that the grounds for NASD's decision to delist Fog Cutter's securities from Nasdaq exist in fact:

> NASD made clear the bases for its conclusion that the public interest required delisting of Fog Cutter: Wiederhorn's guilty plea to two felonies; his continuing influence over the company notwithstanding his imprisonment; the negotiation of the Amended Employment Agreement; the agreement to pay $2 million to cover the cost of court-order restitution in addition to the other terms of the Leave Agreement; and Fog Cutter's intention to have Wiederhorn act as CEO while incarcerated. These factors led NASD to conclude that Fog Cutter, with Wiederhorn in control under only nominal Board supervision, was an issuer that presented inappropriate non-market risk to public investors and, consequently, should be delisted.

Op. 10. Substantial evidence clearly supports the Commission's finding that these factual grounds exist in the record. Indeed, Fog Cutter does not dispute that: Wiederhorn pled guilty to two federal felonies, one of which involved filing a false tax return (R. 103; J.A. 28); when Wiederhorn was being investigated for crimes admittedly unrelated to Fog Cutter, the Board amended his employment agreement to make it virtually impossible to terminate his employment for any felony convictions that may have resulted from the CCI investigation (R. 316, 319; J.A. 211, 214); the day before Wiederhorn pled guilty, the Board designated him Co-CEO and Co-Chairman, agreed to pay his full salary, bonuses, and benefits while in prison, and agreed to pay the $2 million in restitution ordered in his criminal case (R. 103, 107-11; 890; J.A. 28, 32-36, 327); the Board's apparent intention was to have Wiederhorn act as Co-CEO from his prison cell, since the Board removed him from that position only after prison authorities informed them that Wiederhorn would be unable to conduct business from prison (R. 225; J.A. 129).

Fog Cutter claims (Br. 4, 12, 38-39) that its Board "consistently acted to protect the Company's value and its shareholders' investments" and made its decisions as "business judgments" with the shareholders' best interests in mind. The company thus contests the Commission's finding that "the Board, in

negotiating Wiederhorn's Amended Employment Agreement and acquiescing in his desire for the Leave Agreement, put Wiederhorn's interests above those of the shareholders." Op. 11. Substantial evidence, including every one of the Board's questionable decisions, supports the Commission's finding. *See id.* at 9 (listing Board's questionable decisions as evidence to support NASD's conclusion that "Wiederhorn so thoroughly influenced the Board that it provided no check upon Wiederhorn's conduct"). Indeed, the Commission noted as a further example, that the Board agreed to pay $4,750,000 in "leave of absence expense" to Wiederhorn during the same period that the company reported a net loss of $3,932,000. *Id.* at 11.

2. The Commission Did Not Abuse Its Discretion in Concluding that NASD's Decision Was in Accordance with Its Rules.

As the Commission correctly found, NASD's decision was made pursuant to its "necessarily broad" (Op. 8) authority "to apply additional or more stringent rules to issuers listed on Nasdaq when an 'event, condition, or circumstance' makes application of stricter standards advisable" (Op. 7 (quoting NASD Marketplace Rule 4300)) and to do so "to protect investors and the public interest" (Op. 7 (citing NASD Marketplace Rule 4330)). As the Commission stated, "[l]isting a security on a market creates expectations among investors that listed

companies meet basic standards of corporate governance and financial soundness" and "'entail[s] an element of judgment given the expectations of investors and the imprimatur of listing on a particular market.'" Op. 11 (quoting *DHB Capital Group*, 52 S.E.C. at 744). The Commission reasoned in approving NASD Marketplace Rules 4300 and 4330 that permitting NASD the discretion to make this determination is appropriate since "[s]ecurities listed for trading or included in Nasdaq often qualify for margin loans and are exempt from many of the state blue sky laws, which apply concepts of merit regulation to determine whether investors in that state may purchase the issuer's securities." 59 Fed. Reg. at 29,845. *See also Tassaway*, 45 S.E.C. at 710 ("To the extent that discretion enters into the matter—and it very often does—the discretion in question is the NASD's, not ours."). The Commission determined that NASD's grounds for delisting Fog Cutter satisfied this standard and justified NASD's action. Op. 7-12.

Relying on *WHX Corp. v. SEC*, 362 F.3d 854, 861 (D.C. Cir. 2004), and *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1099 (D.C. Cir. 2005), Fog Cutter argues (Br. 41) that the Commission did not adequately explain why delisting was in the public interest. This is far from the case, however. The Commission found, on an independent review of the record, that NASD's decision was in the public interest because NASD justifiably was concerned that Wiederhorn, who had pled

guilty to two felonies, would continue to exert influence and control over Fog Cutter's business even while incarcerated and that the Board would serve as no effective check on his influence. Op. 8. The Commission found support for its decision here in *JJFN*, which sustained NASD's decision not to list JJFN because a controlling person with the company previously had pled guilty to, among other charges, filing a false tax return in violation of 26 U.S.C. 7206(1). *Id.* The Commission stated here "that '[b]oth the tax and the securities regulatory schemes depend on the honor, candor, and integrity of regulated persons to report accurately to the regulatory authority the information sought by such authority,' and that the conviction of a controlling person for 'tax fraud legitimately may be considered by the NASD to be evidence of a propensity for future conduct violative of securities laws or regulations.'" *Id.* (quoting *JJFN*, 53 S.E.C. 338-39).

Fog Cutter contends (Br. 36-37) that the Commission erred in relying on *JJFN* because it involved a controlling person who was involved in a "pattern" of illegal conduct related to that person's previous company in contrast to Wiederhorn, who pled guilty to an "intentless" offense and to filing a false personal—not corporate—tax return based on advice of counsel. The Commission, however, reasonably rejected Fog Cutter's attempts to minimize the conduct underlying Wiederhorn's convictions. Op. 7 & n.16, 8.

With respect to Wiederhorn's illegal-gratuity conviction, Fog Cutter elsewhere concedes (as it must) that, even though the statute does not require a *quid pro quo*, the crime is not, in fact, "intentless." Br. 11. *See also* R. 108, 871-72; J.A. 33, 308-09. In finding one of the other CCI defendants guilty of violating this same statute, the court interpreted the statute as requiring that the defendant gave a "thing of value" to an ERISA plan fiduciary "because of" the fiduciary's "specific actions or decisions that [the defendant] anticipated" or "because of" the fiduciary's "specific past actions or decisions that [the defendant] intended to reward." *United States v. Kirkland*, 330 F. Supp. 2d 1151, 1174 (D. Or. 2004). *Cf. United States v. Sun-Diamond Growers of Cal.*, 526 U.S. 398, 404-05 (1999). As Fog Cutter concedes (Br. 8), Wiederhorn violated this statute by providing an improper benefit—forgiving $3.5 million in personal guarantees—to an ERISA plan fiduciary "because of" the fiduciary's agreement to give Wiederhorn's former company $25.3 million in investor funds, consisting of a $6 million loan and the release of $19.3 million held as a cash reserve pursuant to previous loan obligations. *See also* R. 198-99; J.A. 123-24. It does not matter that Wiederhorn did not intend to violate the statute when he undertook this course of action. *See, e.g., Cheek v. United States*, 498 U.S. 192, 199 (1991).

Moreover, with respect to Wiederhorn's conviction for filing a false tax return, as the Commission pointed out, "Fog Cutter does not suggest that filing a false tax return does not require intent." Op. 7 n.16. In addition, the Commission rejected the company's attempt to distinguish Wiederhorn's personal tax fraud from the *JJFN* controlling person's corporate tax fraud: "The wrong committed by an untruthful taxpayer is telling a falsehood to an agency that relies upon truthful reporting of economic activity," and is no different where "the falsehood was uttered by the taxpayer on his personal return instead of on a business return." *Id.* at 8.

Fog Cutter contends (Br. 37) that the Commission "missed the point" of its claim that because Wiederhorn's criminal conduct purportedly was engaged in only after obtaining the advice of counsel, Wiederhorn would not be likely to violate the law in the future. The Commission reasonably rejected this argument. Op. 7 n.16. Wiederhorn pled guilty to two felonies—one of which involved his actions as an officer of his previous business, while the other involved willfully signing what he knew was a false federal tax return. As the Commission stated, "we believe the sentence of eighteen months imprisonment (fourteen of which were served), payment of a $25,000 fine, and payment of $2 million in restitution make clear the seriousness of the offenses." *Id.* at 7. Further, Wiederhorn's

assertion that he relied on advice of counsel in filing a false tax return contradicts the basis for his guilty plea to this crime because such reliance would have necessarily negated his *mens rea*. As the Commission recognized, the Supreme Court has held that "willfully" signing and filing a false tax return means that the filer engaged in a "'voluntary, intentional violation of a known legal duty.'" Op. 7 n.16 (quoting *United States v. Bishop*, 412 U.S. 346, 360 (1973)). *See also Cheek*, 498 U.S. at 199-200. Thus, the Commission refused to allow Fog Cutter to collaterally attack the basis of Wiederhorn's convictions. Op. 7 n.16.

Fog Cutter argues (Br. 33-34, 46) that, instead of following *JJFN*, the Commission should have followed *e-Smart Technologies, Inc.*, Initial Decision Release No. 272 (Feb. 3, 2005), 84 SEC Dkt. 2979; Finality Order Release No. 51309 (March 3, 2005), 84 SEC Dkt. 3387, where an issuer's securities registration was not suspended or revoked for reporting violations. As the Commission pointed out, reliance on this "and other registration revocation cases . . . is misplaced, as those cases are inapposite." Op. 11 n.31. Specifically, revocation of an issuer's securities registration under Section 12(j) of the Exchange Act means that the issuer's securities may not be traded publicly at all; on the other hand, when NASD delists an issuer's securities, those securities may still be traded publicly—like Fog Cutter's securities, which are quoted on the Pink

Sheets. *Id.* *See Air L.A., Inc.*, 1994 WL 413098, at *2 ("[T]here is a distinction between the right of a company to offer its securities publicly and its ability to choose the marketplace on which its securities will trade.").

Fog Cutter also claims (Br. 19, 21-22, 27-28, 32, 38) that the Commission abused its discretion by impermissibly "second-guessing" the Board's business judgment, including its purported concerns with avoiding litigation with Wiederhorn and with minimizing the risk of losing any accrued gain in GEMB if the GEMB minority owners were to exercise their buy-out option. As the Commission stated, "[t]he issue here . . . is not the Board's business judgment but, rather, the public interest," and the Commission found that NASD's determination that the public interest required delisting of Fog Cutter's securities was sound. Op. 11. Further, as noted *supra* at 32-33, the Commission's factual finding that Fog Cutter's Board put Wiederhorn's interests above those of the shareholders is supported by substantial evidence in the record and is, therefore, conclusive on this issue. Indeed, as the Commission pointed out, Fog Cutter's need to avoid litigation with Wiederhorn over his amended employment agreement arose only because the Board capitulated in his demands for a revised agreement that would ensure that he could not be terminated "for cause" for a felony conviction arising out of the CCI investigation. Op. 9. Moreover, Fog Cutter's claim (Br. 4, 27) that

NASD and the Commission second-guessed the Board's actions "after-the-fact" ignores the Commission's finding that the Board at no time sought NASD's advice to determine, before-hand, what the regulatory response might be—even though Wiederhorn and the rest of the Fog Cutter Board clearly were aware of the potential "controversial" consequences of the Board's decisions. R. 885-86, 900; J.A. 322-23, 337; Op. 11. *See DHB Capital Group*, 52 S.E.C. at 744-45.

Fog Cutter also points to a number of facts that it claims the Commission "ignored." The facts Fog Cutter points to are irrelevant.

It was not necessary for the Commission to address the company's claims that it did not violate any laws (Br. 31), conceal any of the relevant facts from the public as they occurred (Br. 32, 37, 39, 42-44), fail to maintain the minimum quantitative criteria for trading on Nasdaq once delisted (Br. 43-44), or that the Board members were re-elected by the company's shareholders (Br. 44). It is irrelevant that Fog Cutter itself was not charged with violating the securities or any other laws—no one at any point in the proceedings was under the mistaken impression otherwise. Rather, Fog Cutter was delisted to protect the public interest pursuant to NASD Marketplace Rules 4300 and 4330, which do not require a violation of law by the issuer to justify a decision to delist. In contrast, revoking an issuer's registration under Section 12(j) of the Exchange Act does

require a finding of a violation of the Exchange Act. *See, e.g., Gateway Int'l Holdings, Inc.*, Exchange Act Release No. 53907, 2006 WL 1506286, at *4 (May 31, 2006).

It is likewise irrelevant that the company continued to trade at or above Nasdaq minimums or that the Board apparently continued to receive the support of its shareholders. The Commission has stated, "[m]eeting the minimum listing requirements . . . does not guarantee a listing, nor does an agreement to do more than the minimum required." *DHB Capital Group*, 52 S.E.C. at 744. Moreover, the Commission has recognized that, "[t]hough exclusion from [Nasdaq] may hurt existing investors, primary emphasis must be placed on the interests of prospective future investors." *Tassaway*, 45 S.E.C. at 709. *See also, e.g., Outsource Int'l, Inc.*, Exchange Act Release No. 44944, 2001 SEC Lexis 2169, at *19-*20 (Oct. 17, 2001) (collecting cases).

3. The Commission Did Not Abuse Its Discretion in Concluding that NASD's Decision Was Consistent with the Exchange Act and Did Not Unfairly Single-Out Fog Cutter.

The Commission concluded that NASD's decision to delist Fog Cutter's securities based on public interest concerns was consistent with the Exchange Act. Op. 11. Fog Cutter argues (Br. 45-48) that NASD's decision to delist Fog Cutter is unfair when compared to how two other issuers whose controlling persons were

convicted of felonies were treated, and the Commission thus abused its discretion in failing to explain why NASD (and the New York Stock Exchange) failed to bring delisting proceedings against these two other issuers.

Fog Cutter's argument fails for a number of reasons. As the Commission correctly pointed out in rejecting this argument below, "each case is to be decided on its own facts and circumstances, and it is not appropriate to compare them." Op. 11 (citing *Butz*, 411 U.S. at 187, and *DHB Capital Group*, 52 S.E.C. at 745). In *Butz*, the Supreme Court reversed a court of appeals decision finding an agency's sanction to be "unwarranted in law" based upon the fact that it was more severe than four of the agency's previous decisions in similar circumstances. 411 U.S. at 185-86. Although *Butz* involved an administrative sanction, its rationale applies equally here. The Court rejected the court of appeals' conclusion that "the sanction was 'unwarranted in law' because 'uniformity of sanctions for similar violations' is somehow mandated by the Act." *Id.* at 186. Rather, the Court held, "[t]he employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases." *Id.* at 187. In other words, "mere unevenness in the application of the sanction does not render its application in a particular case 'unwarranted in law.'" *Id.* at 188.

Fog Cutter's argument is even weaker than that rejected in *Butz* and its progeny. Typically, a petitioner argues that the sanction he received for a particular violation was disparately harsh as compared to someone who was also found to have committed a similar violation. Here, however, Fog Cutter asks the Court to reverse the Commission's decision because the Commission refused to compare NASD's decision to delist Fog Cutter from Nasdaq to the *absence of* an NASD decision to bring a delisting proceeding against a different issuer, Steve Madden Ltd, under circumstances that Fog Cutter claims were similar. Fog Cutter asserts that the delisting decision here was "out of step with actions (and more significantly, *inactions*) taken . . . with respect to other similarly situated issuers." Br. 29 (emphasis in original). Since no proceeding was brought, however, there is no way to compare the facts or the deliberative process (if any) that led NASD to *not* bring a delisting proceeding against Steve Madden Ltd. In effect, Fog Cutter's argument is a selective enforcement argument, which must be based on a claim that the decision to bring a delisting proceeding against Fog Cutter was motivated by use of a suspect classification such a race or religion, or by the desire to prevent the exercise of a constitutionally protected right. *See, e.g., Eagletech Communications, Inc.*, Exchange Act Release No. 54095, 2006 WL 1835958, at

*4 (July 5, 2006); *Henderson v. Kennedy*, 253 F.3d 12, 17-18 (D.C. Cir. 2001). Fog Cutter cannot establish such a claim.

Fog Cutter not only asks this Court to compare NASD's decision to delist its securities to one instance in which NASD did not bring delisting proceedings against Steve Madden; Fog Cutter also asks this Court to compare NASD's decision to delist its securities with the *absence of* a *New York Stock Exchange* decision to bring a delisting proceeding against Martha Stewart Living Omnimedia Inc. This argument likewise fails for the reasons discussed above.

In any event, Fog Cutter fails to support its claim that it is similarly situated to these two issuers. The decision to delist Fog Cutter was based on three principal grounds—the Board's decision to amend Wiederhorn's employment agreement to severely restrict the company's ability to terminate him if the CCI investigation resulted in a felony conviction for Wiederhorn, the Board's agreement to pay his criminal restitution, and the Board's apparent intention to have him serve as Co-CEO while incarcerated. Fog Cutter does not even assert that the other issuers amended their executives' employment agreements in this way or intended to have their CEOs run the companies from prison. Although Fog Cutter implies (Br. 48) that, in regard to its payment of Wiederhorn's criminal

restitution, "the same or substantively identical facts" were true with these other issuers, Fog Cutter cites nothing in support.

Finally, Fog Cutter mistakenly relies on *Blinder, Robinson*, 837 F.2d at 1112-13, where this Court, in remanding a disciplinary sanction to the Commission based on exclusion of evidence regarding the petitioner's relationship with counsel, directed the Commission to consider the "non-frivolous claim" that the petitioners were "singled out for disproportionately harsh treatment" as part of a "*systemic pattern of disparate treatment*, resulting in predictably, disproportionately harsh sanctions being visiting upon" similarly-situated parties. As noted, Fog Cutter has not established that these issuers were similarly situated. In any event, two cases do not constitute a pattern. *Cf. Edwards v. First Nat. Bank*, 872 F.2d 347, 352 (10th Cir. 1989) ("[P]roof of two acts, without more, does not a pattern make.").

CONCLUSION

For the foregoing reasons, the order of the Commission should be affirmed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 9,812 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Circuit Rule 32(a)(2).

I also certify that 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 it has been prepared in a proportionally spaced typeface using Word Perfect in 14-Point Times New Roman.

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September 20, 2006

ADDENDUM

STATUTORY ADDENDUM

Section 19(f) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(f):

SEC. 19(f) In any proceeding to review the denial of membership or participation in a self-regulatory organization to any applicant, the barring of any person from becoming associated with a member of a self-regulatory organization, or the prohibition or limitation by a self-regulatory organization of any person with respect to access to services offered by the self-regulatory organization or any member thereof, if the appropriate regulatory agency for such applicant or person, after notice and opportunity for hearing (which hearing may consist solely of consideration of the record before the self-regulatory organization and opportunity for the presentation of supporting reasons to dismiss the proceeding or set aside the action of the self-regulatory organization) finds that the specific grounds on which such denial, bar, or prohibition or limitation is based exist in fact, that such denial, bar, or prohibition or limitation is in accordance with the rules of the self-regulatory organization, and that such rules are, and were applied in a manner, consistent with the purposes of this title, such appropriate regulatory agency, by order, shall dismiss the proceeding. If such appropriate regulatory agency does not make any such finding or if it finds that such denial, bar, or prohibition or limitation imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this title, such appropriate regulatory agency, by order, shall set aside the action of the self-regulatory organization and require it to admit such applicant to membership or participation, permit such person to become associated with a member, or grant such person access to services offered by the self-regulatory organization or member thereof.

CERTIFICATE OF SERVICE

I certify that on this 20th day of September, 2006, I caused to be filed by hand delivery the original and 14 copies of the foregoing Final Brief of the Securities and Exchange Commission, Respondent, with the Clerk of the United States Court of Appeals for the District of Columbia Circuit, and caused to be served by Federal Express overnight delivery two copies of the same on counsel for petitioner at the following address:

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