ORAL ARGUMENT HELD 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

SUPPLEMENTAL BRIEF FOR PETITIONER

MICHAEL HANIN, ESQ.
LEIGH MCMULLAN BELLAS, ESQ.
KASOWITZ BENSON TORRES
& FRIEDMAN LLP
Attorneys for Petitioner
1633 Broadway
New York, New York 10019
(212) 506-1700
mhanin@kasowitz.com

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

ARGUMENT

At the February 6, 2012 oral argument, the Court recognized that the SEC "cannot arbitrarily and capriciously choose between litigants as to how they apply the rules," and requested supplemental briefing "on the prior history of the SEC's application of receiving or not receiving defenses in default circumstances." (Tr. at 21, 23.) The SEC's supplemental brief demonstrates not only that the SEC's supposed "interpretation" of Rule 155(b) *in this case* was arbitrary and capricious, but that the SEC has no consistent or principled interpretation of Rule 155(b) other than what "seem[s] appropriate" to the SEC at the time.[1] The SEC's Decision was therefore unlawful and lacked substantial justification, and the default should be set aside so that Rapoport can defend the SEC's claims on their merits.

I. The SEC's Decision To Disregard Rapoport's Defenses and Deny Rapoport's Rule 155(b) Motion Was Arbitrary And Capricious

The SEC's supplemental brief marshals "all of the Commission decisions granting or denying motions to set aside defaults" (Br. at 1), and confirms that before the Decision, the SEC *never* – under any circumstances – refused to consider a party's proposed defenses in deciding a Rule 155(b) motion. Similarly, the SEC's supplemental brief confirms that before the Decision, the SEC *never* – under any circumstances – deliberately refused to consider *any* of Rule 155(b)'s

[1] *In re Kern*, 2005 SEC LEXIS 744, at *2 (Feb. 1, 2005).

three plain-text requirements – *i.e.*, that "a motion to set aside a default shall (i) be made within a reasonable time, (ii) state the reasons for the failure to appear or defend, and (iii) specify the nature of the proposed defense in the proceeding." To the contrary, several of the opinions cited by the SEC demonstrate that before the Decision, the SEC "interpreted" Rule 155(b) to *require* consideration of each of the three requirements, even where one or more had not been met to the SEC's satisfaction under the circumstances.

The SEC's decisions also demonstrate conclusively that the SEC follows no guidelines, principles or measurable standards when deciding whether to set aside a default under Rule 155(b). Not one of SEC's decisions explains or addresses *how* the SEC decides if there is "good cause" to set aside a default, or *how* Rule 155(b)'s three textual requirements are assessed or balanced (if at all) and inform the "good cause" determination (if at all). Instead, the SEC's decisions reflect *ad hoc* (and contradictory) decision-making that is untethered to discernable guidelines or principles.

A. The SEC Has No Guidelines Or Principles For Deciding Motions To Set Aside Defaults Pursuant To Rule 155(b)

The SEC's hindsight attempt (Br. at 2-5) to classify its Rule 155(b) decisions into "categories" not only reveals nothing about why the SEC refused to consider Rapoport's proposed defenses in the Decision, but confirms that the SEC applied

no consistent guidelines when deciding Rule 155(b) decisions in the past, and has no predictable guidelines for deciding Rule 155(b) motions in the future.

The SEC's brief merely takes the same four opinions (*Richards, Hellen, Ainbinder, and Bullard*) that this Court advised the SEC at oral argument "do not stand for the proposition you cite them for" (Tr. at 18-19) – apparently the only four opinions in which the Commission has ever denied a motion to set aside a default – and places them into Categories 1 and 2.[2] This Court (Tr. at 17-20) has already recognized, however, that none of these cases supports the SEC's supposed exercise of discretion in this action because, among other things, none reflects the SEC *declining* to consider a party's proffered defenses. The SEC's argument (Br. at 7) that the Decision is "comparable" to these cases is, as this Court already

[2] The SEC places *In re Bullard*, 1995 SEC LEXIS 3049 (Nov. 9, 1995) in Category 2 based solely on the fact that in *Bullard*, the SEC stated that the defaulting party had "timely filed" his Rule 155(b) motion. The SEC's analysis of the "reasonable time" requirement in *Bullard* was – not surprisingly given the absence of any principles or guidelines – inconsistent with the SEC's analysis in the Decision. In *Bullard*, the SEC concluded that the default motion was "clearly timely filed" based *solely* on the fact that Bullard moved shortly after receiving notice of the default, and ignored the fact that Bullard had been in default for months and had disregarded repeated warnings from the ALJ to file an answer. In the Decision, however, the SEC rejected Rapoport's contention that he moved within a "reasonable time" of being served personally (and properly, for the first time) with the Default Order because "we look at more than just the date that he was personally served with the Default Order," such as the date on which the OIP was filed, the date on which Rapoport was required to answer, and the fact that Rapoport had actual notice of the OIP. *See* JA-22.

recognized, without support.[3] In the only Rule 155(b) case cited by the SEC in which a defaulting party specified defenses but failed to "adequately explain why it failed to file a timely answer," the law judge *nonetheless considered the party's proposed defenses*. *In re RDM Sports Group, Inc.*, 2009 SEC LEXIS 3631, at *8-22 (Nov. 3, 2009). This is *directly contrary* to the litigation position advanced by the SEC here.[4]

The SEC's brief (Br. at 4-5) creates a third category[5] to cover the only two decisions in which the SEC actually set aside a default: *Kern* and *Birman*. In *Kern*, the SEC referenced the "good cause" standard, stated that "[t]he Commission grants motions to set aside a default when to do so would prevent

---

[3] For example, the defaulting party in *Richards* offered no explanation for waiting *more than twenty years* to set aside the default, but rather than announce – as the SEC did in the Decision – that Richards had waived his right to have his defenses considered, the SEC specifically noted that "Richards' motion does not specify his proposed defense . . ." *In re Richards*, 1994 SEC LEXIS 2663, at *6 (Aug. 29, 1994). In *Bullard*, the SEC noted Rule 155(b)'s three textual requirements, stated that good cause "is a broad standard," and then denied Bullard's motion based on the "circumstances" without any discernable reference to the three requirements, or any other principles or guidelines. *In re Bullard*, 1995 SEC LEXIS 3049, at *2 (Nov. 9, 1995).

[4] The SEC's attempt (Br. at 5, fn. 1) to discount the law judge's obvious consideration of proposed defenses in *RDM Sports* is frivolous, and is belied by the law judge's lengthy discussion of multiple proposed defenses (only one of which was a "practical solution") after which the law judge concluded that "PAD's proposed defenses have no likelihood of success under the Commission's case law." *In re RDM Sports Group, Inc.*, at *8-22.

[5] The SEC also creates a fourth category, not relevant here, covering instances where defaults have been set aside by consent (Category 4).

injustice, and *under such conditions as seem appropriate*," and set aside the default based on an "explanatory affidavit," without indicating what the explanation was or why it was sufficient. *In re Kern*, 2005 SEC LEXIS 744, at *2 (Feb. 1, 2005) (emphasis added). In *Birman*, the SEC did not even mention (let alone elucidate) the "good cause" or "appropriate condition" standard, and granted the motion based on a succinct finding that the defaulting party's "filing complies with the [three textual] requirements of Rule 155(b)." *In re Birman Managed Care, Inc.*, 2008 SEC LEXIS 2810, at *2 (Sept. 23, 2008). Not only do these two cases reflect blatantly inconsistent applications of Rule 155(b), but the SEC's assertion (Br. at 7) that the "the Commission found good cause" in *Birman* is false, as *Birman* does not find, or even mention, "good cause."[6]

The universe of SEC's Rule 155(b) decisions therefore confirms what the SEC conceded at oral argument: that the SEC's decides whether or not to set aside a default without reference to any consistent standard, principle or rule, and based entirely "on the circumstances of the particular default." (Tr. at 21-22.) As the Court made clear, "that is not an answer." *Id.* The Decision was therefore unlawful and without substantial justification.

[6] Moreover, *Birman* does not appear to be a Commission decision, as it was signed by Carol Fox Foelak, an administrative law judge. The SEC arbitrarily addresses this case (*compare* Br. at 4 to Br. at 5, fn. 1) as a decision by the Commission.

B. The SEC's Refusal To Consider Rapoport's Proposed Defenses Was Contrary To Rule 155(b)

Despite having never before deliberately refused to consider one of the three requirements stated in Rule 155(b), the SEC argues (Br. at 6-9) that its arbitrary decision to disregard Rapoport's defenses was "not inconsistent with its prior practice and the text of the regulation." The SEC's argument is not only immaterial (the Decision was arbitrary and capricious, in any event), but it is provably false with respect to the SEC's prior practice (*see supra*) and the text of Rule 155(b).

Rapoport has previously demonstrated (Reply Br. at 3-5) that the SEC's interpretation of Rule 155(b) makes no sense. The SEC announced in the Decision that by "fail[ing] to file a timely answer" to the OIP, "Rapoport denied himself the opportunity to present [his] defenses." *See* JA-24. Based on that interpretation, however, a defaulting party – who, by definition, has failed to "file a timely answer" – could *never* present defenses in connection with a motion to set aside a default. This is inconsistent with Rule 155(b)'s requirement that a party "specify the nature of the proposed defense."[7]

[7] Contrary to the SEC's false contention (Br. at 9), the SEC's so-called "interpretation" of Rule 155(b) is erroneous without regard to whether Rule 155(b) requires a balancing of factors consistent with the axiomatic federal standard (which, for all of the reasons set forth in Rapoport's briefs, it does).

Rule 155(b) also does not state – as the SEC repeatedly and erroneously contends (Br. at 6) – that the SEC will not consider proposed defenses if a defaulting party's "explanation" or "justification" for failing to file a timely answer is "insufficient" or "unreasonable." (Br. at 1-3, 6, 7.) The SEC fabricates these terms because – without reference to the axiomatic three-factor balancing test[8] – the SEC *has no guidelines* for evaluating and/or weighing Rule 155(b)'s requirements,[9] or for determining whether "good cause" exists to set aside a default. At oral argument, the SEC argued that it "didn't consider" Rapoport's defenses because "the default was willful" and based on "the Commission's finding of willfulness." (Tr. at 22, 24.) But the SEC has no basis for evaluating if a default is sufficiently "willful" to warrant disregarding proposed defenses, because "willfulness" is one of three factors that *federal courts* consider when interpreting FRCP 55(c), and appears nowhere in Rule 155(b) or the SEC's decisional law.

---

[8] Because the SEC rule for setting aside defaults mirrors FRCP 55(c) and employs the exact same "good cause" standard, Rapoport, the SEC's Division of Enforcement and the ALJ *each* presumed that the axiomatic three-factor federal balancing test for "good cause" applied to this action. *See* Reply Br. at 4-6. Other law judges have reached the same conclusion. *See also In re WSF Corp.*, Admin. P. 3-10668 (March 1, 2002), available at http://www.sec.gov/alj/aljorders/2002/3-10668.pdf ("Rule 155(b) of the Commission's Rules of Practice is to the same effect" as FRCP 55(c)).

[9] Rapoport satisfied Rule 155(b)'s plain text requirement by "stating his reason for failing to appear" – that he did not believe he was required to appear before he was properly served by the SEC (which is precisely what he did after he was served personally for the first time).

The SEC's reliance on select portions of the federal court test here epitomizes the SEC's inconsistent reliance on federal rules generally, including the SEC's reliance on the federal courts' materially different rule regarding service on foreigners to "direct service" on Rapoport through his former U.S. counsel. *See* Reply Br. at 15-17, fns. 26-28.

The SEC ultimately concedes (Br. at 8-9) that the Decision represents a material departure from its previous cases, but asks this Court to defer to the SEC's unprecedented and unprincipled so-called "interpretation" of its own rule. The SEC's arbitrary and capricious "interpretation" is not entitled to deference by this Court.

II. The Default Order Should Be Set Aside

Because the SEC's Decision was arbitrary and capricious, the default order against Rapoport should be vacated pursuant to Section 706(2)(A) of the Administrative Procedures Act ("APA"), which requires that courts "shall hold unlawful and set aside" arbitrary and capricious agency decisions. 5 U.S.C. § 706(2)(A)); *see also Owner-Operator Ind. Drivers Ass'n, Inc. v. Fed. Motor Carrier Safety Admin.*, 494 F.3d 188, 198, 377 (D.C. Cir. 2007) (unlawful agency action "must" be set aside); *Am. Fed'n of Gov't Employees, AFL-CIO, Local 446 v. Nicholson*, 475 F.3d 341, 354 (D.C. Cir. 2007)(same); *Milk Train, Inc. v. Veneman*, 310 F.3d 747, 757 (D.C. Cir. 2002) (Sentelle, J., dissenting) ("once a

reviewing court determines that the agency has not adequately explained its decision, the Administrative Procedure Act requires the court – in the absence of any contrary statute – to vacate the agency's action") (internal quotation omitted).

The default order should be set aside in its entirety here. Unless the SEC adopts the axiomatic three-factor balancing test for "good cause" (which it should, for all of the reasons set forth in Rapoport's briefs) the Decision is irredeemable given that, as the SEC's decisions make clear, the SEC has no principles or guidelines for deciding motions to set aside default orders. Rapoport has already twice presented "good cause" to the SEC,[10] and should not be made to do so for a third time after the SEC adopts a lawful rule for determining when defaults should be set aside.

Respectfully submitted,

Dated: February 24, 2012

By: /s/ Michael A. Hanin

Michael A. Hanin
Leigh McMullan Bellas
Kasowitz, Benson, Torres & Friedman LLP
1633 Broadway
New York, NY 10019
(212) 506-1700
mhanin@kasowitz.com
lmcmullan@kasowitz.com

Counsel for Petitioner Dan Rapoport

[10] *See* Reply Br. at 6, fn. 10.

CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the Court's February 6, 2012 order because it is limited to nine pages, excluding the cover page, table of contents, table of authorities, and certificates of compliance and service. I also certify that this brief is written in Times New Roman 14-point font.

Dated: February 24, 2012 /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 Supplemental Brief For 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:

Jeffrey Alan Berger
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Direct: 202-551-5112
Email: bergerje@sec.gov

Jacob H. Stillman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Direct: 202-551-5017
Email: stillmanj@sec.gov

Additionally, eight hard copies will be delivered to the Clerk of the Court and two courtesy copies will be delivered to the above-named counsel via express mail.

Dated: February 24, 2012 /s/ Michael A. Hanin

Michael A. Hanin