UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: JOHN P. FLANNERY and JAMES D. HOPKINS	)	ADMINISTRATIVE PROCEEDING FILE NO. 3-14081

RESPONDENT JOHN PATRICK ("SEAN") FLANNERY'S
MOTION FOR SUMMARY AFFIRMANCE

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Pursuant to Rule 411(e) of the Securities and Exchange Commission's ("Commission") Rules of Practice, Respondent John Patrick ("Sean") Flannery ("Flannery") respectfully moves for an order summarily affirming the Initial Decision issued by Chief Administrative Law Judge Brenda P. Murray on October 28, 2011.[1]

I. INTRODUCTION & BACKGROUND

Chief Judge Murray found in Flannery's favor on all of the Division of Enforcement's ("Division") claims — those based on theories actually articulated in the Order Instituting Proceedings ("OIP"), the Division's pre-hearing brief, and at the hearing; as well as those that were first unveiled in the Division's post-hearing briefs. Chief Judge Murray found that Flannery was credible and honest; that he never sought to mislead investors and instead sought at all times to act in their best interests; and that he did not, in fact, mislead investors. Moreover, Flannery took care to ensure that knowledgeable and experienced attorneys reviewed and approved each of the letters at issue. These findings are supported by the mountain of evidence presented at the hearing.

In 2007, the Division commenced an investigation concerning losses sustained by State Street Global Advisors' ("SSgA") Limited Duration Bond Fund ("LDBF") as a result of the unprecedented subprime mortgage crisis in the Summer of 2007. LDBF was an unregistered fund designed to generate returns well in excess of money market funds. Initial Decision 2, 4. LDBF was a small part of SSgA's assets under management ("AUM"), representing less than 1% of the almost $2 trillion in AUM for which Flannery, as Chief Investment Officer, Americas, was responsible. Hearing Transcript ("Tr.") 1142-46; Initial Decision 6. Flannery had no role in

[1] The Division also seeks review of the Initial Decision as to James Hopkins. There is little overlap in the Division's allegations against Hopkins and Flannery.

LDBF's creation, investment decisions, or day-to-day management. Initial Decision 7. He also had no responsibility for investor communications about LDBF or any other fund. *Id.* at 30.

Flannery received a Wells Notice on June 25, 2009, and on September 30, 2010 the Division filed its OIP, alleging Flannery was liable under Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 (and Rule 10b-5) for alleged misstatements and omissions in two letters SSgA sent to investors in August 2007 regarding LDBF's performance. Initial Decision 2; OIP ¶ 37-41. The OIP alleged no misconduct against Flannery in connection with any other letter or event. *See, e.g.*, OIP at ¶ 35 (no misconduct alleged against Flannery in connection with July 26 letter). It was not until the Division filed its post-hearing briefs that it articulated purported theories of liability against Flannery beyond the August letters.

The Division's theories were based on the notion that Flannery, a man with an unblemished, 27-year career in the investment business, an uncontested history of honesty and integrity, and a vast commitment to charitable works, acted wildly out of character for a few weeks in 2007. But Chief Judge Murray found, after an eleven-day hearing involving ten witnesses for the Division, nine witnesses for Respondents, and approximately 500 exhibits, that the evidence painted a very different picture. Her thoughtful and well-reasoned 58-page Initial Decision dismissed all of the Division's claims, new and old, finding that Flannery did not mislead anyone and, moreover, that he lacked scienter and was not reckless or negligent. She explicitly found that he testified truthfully and with candor and conviction, and witnesses were unanimous in their testaments about his honesty, good character, and concern for clients.

Notwithstanding the overwhelming evidence exonerating Flannery, the Division continues to pursue its debunked case. The Division's Petition focuses on two aspects of the

Initial Decision: (1) Chief Judge Murray's application of the U.S. Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011); and (2) her application of investor sophistication principles in an enforcement action. Petition 3. While Flannery disagrees with the Division on these issues, their resolution makes no difference in Flannery's case, as the Initial Decision is premised on a number of other, independent grounds, each of which support the result, including the findings that (1) the letters contained no misstatements or omissions, and (2) Flannery did not act intentionally, recklessly, or negligently. Thus, *even if* the Commission were to agree with the Division regarding the scope of *Janus* and investor sophistication, it would not change the outcome of this case.[2]

The Commission should summarily affirm the Initial Decision and dismiss the claims against Flannery once and for all. At a minimum, the Commission should affirm Chief Judge Murray's determination that Flannery is not liable, excepting from its order her findings concerning the scope of *Janus* and investor sophistication. After years of living under the cloud created by the investigation, Flannery should not be deprived of the exoneration provided by the Initial Decision due to disputes over legal issues having no bearing on the outcome.

II. THE COMMISSION SHOULD SUMMARILY AFFIRM THE INITIAL DECISION.

A petition for review must make a "reasonable showing that (1) [a] ***prejudicial error*** was committed in the conduct of the proceeding; or (ii) [t]he decision embodies: (A) [a] finding or conclusion of material fact that is ***clearly erroneous***; or (B) [a] conclusion of law that is ***clearly erroneous***; or (C) [a]n exercise of discretion or decision of law or policy that is ***important*** and

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[2] The Division purports to "petition[] for review all findings contrary to its Rule 340 Proposed Findings including, but not limited to, all proposed findings that documents contained material misstatements." Petition n.1. The Division does not identify any supporting reasons for its blanket exception to "all findings." 17 C.F.R. § 201.410(b). If this were adequate, there would be no need to provide *any* information regarding the basis for review in a Petition. This cannot be a proper interpretation of the Commission's Rules.

that the Commission should review." 17 C.F.R. § 201.411(b)(2) (emphasis added). Here, no prejudicial error was committed, as the Division's proffered grounds for review would not change the result in light of Chief Judge Murray's other, unchallenged findings. Moreover, there simply were no conclusions of law or fact that were clearly erroneous, as discussed below. Finally, to the extent the Division deems Chief Judge Murray's legal conclusions regarding *Janus* and investor sophistication important, it can and should summarily affirm the outcome of the case as to Flannery, while excepting those legal conclusions from its order.[3]

A. Chief Judge Murray Properly Found, Consistent with the Testimony of Every Witness Who Knew Him, that Flannery Was Credible.

Guiding Chief Judge Murray's decision were her detailed findings regarding Flannery's credibility:

> John Patrick (Sean) Flannery (Flannery) and James D. Hopkins (Hopkins) were credible witnesses. This conclusion is based on observing the demeanor of both men during their two days of testimony and scrutiny of their answers compared with all other evidence on the record. The written record does not reflect the tone, the conviction, or assurance conveyed in a witness's oral responses. **Both Respondents answered without hesitation or equivocation and they evidenced candor, conviction, and, at times, frustration. . . . My conclusion is supported by the testimony of every witness who knew Flannery and Hopkins. Testaments of their honesty, good character, hard work, and concern for clients, were delivered enthusiastically and were not simply pro forma statements.**

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[3] While not necessary for purposes of this motion, Flannery will argue on appeal that Chief Judge Murray's application of *Janus* was proper. *See, e.g.*, *SEC v. Kelly*, 2011 U.S. Dist. LEXIS 108805 (S.D.N.Y. Sept. 22, 2011) (holding that where the Division's scheme liability theories are premised on alleged misstatements and omissions, the *Janus* standard for making a statement applies to claims under Rule 10b-5(a) & (c) and Section 17(a)).

Chief Judge Murray's application of investor sophistication principles was also proper. First, she did not require proof of reliance in enforcement actions, as the Division misleadingly contends; she simply held that sophistication is relevant to assess the total mix of information available to investors. Initial Decision 40. Furthermore, LDBF investors were clearly sophisticated. There is no dispute that LDBF was an unregistered fund, most if not all of its investors were institutional, many of whom employed investment consultants. *Id.* at 3-5. And unrefuted expert testimony proved that LDBF's communication and disclosure model was customary and appropriate for unregistered funds at the time. *Id.* at 33. Flannery had no responsibility for this model (*id.* at 30), but he believed investors were receiving substantial information about LDBF from a variety of sources. *Id.* at 31.

Initial Decision 3 (emphasis added). Numerous witnesses, including those called by the Division, testified unequivocally regarding Flannery's honesty and integrity, and this testimony was not contradicted by a single witness. "Flannery has had an unblemished record in the industry and those who have worked with him believe him to be unusually honest, capable, and ethical." *Id.* at 6.

The hearing officer (here, Chief Judge Murray) is in the best position to observe witnesses and make credibility determinations. The record abundantly supports her findings regarding Flannery's honesty and integrity, and is devoid of contrary evidence.

B. The Commission Should Summarily Affirm Chief Judge Murray's Initial Decision Regarding the Allegations Described in the OIP: The August 2 and August 14 Letters

In the OIP, the Division alleged misconduct by Flannery only in connection with two letters sent to investors in August 2007. OIP ¶¶ 37-41. As to both letters, Chief Judge Murray found that Flannery was not liable for a number of reasons, including because the letters contained no misstatements or omissions, and Flannery did not act with the requisite state of mind. These findings were detailed, well-reasoned and based upon the overwhelming weight of the evidence.

1. The August 2 Letter

a. Background

Flannery did not write, request, sign or play any role in distributing SSgA's August 2, 2007 letter to investors, and his involvement was limited to one round of "suggested edits," only five innocuous words of which survived in the final version. As Chief Judge Murray found, "Flannery did not author any of the drafts of the August 2 letter, his name does not appear in the letter, very few of his edits appear in the final product, he did not sign it, he did not have final approval authority . . . ." Initial Decision 53. The August 2 letter was drafted by Adele Kohler

(Product Engineering) on July 31 and sent to various people, not including Flannery, for review. *Id.* at 26. Its purpose was to inform clients of the impact that subprime exposure had on LDBF's July performance. *Id.* Flannery was copied on a subsequent draft of the letter, and while he was not asked to comment, he provided one set of "suggested edits," because he thought they might be helpful, though he understood that a number of other capable people would be reviewing the letter. Div. Exs. 154, 155; Tr. 1318-19; Initial Decision 53. Flannery's suggested edits were designed to make the letter more accurate; where they were not grammatical or stylistic, they painted a negative picture. Flannery Post-Hearing Mem. 48-49.

Flannery never commented on the draft again after suggesting edits. *Id.* at 46-47, 54. SSgA's General Counsel, Mitchell Shames, among many others, including senior members of Relationship Management, the Fixed Income team, Compliance personnel, other members of SSgA's legal department, and outside counsel, were heavily involved in reviewing and editing the letter, both before and after Flannery's suggested edits. Initial Decision 53. "Flannery consistently required that the legal department approve communications to clients" (*id.* at 31), and "the unequivocal evidence is that Legal gave the final sign-off on the letter." *Id.* at 53. "Flannery was not included on a number of the final e-mail exchanges prior to distribution. Only a handful of Flannery's suggested edits remained in the final letter." *Id.* at 28. Just the following five of his suggested words survived: "additionally," "prompting us to" and "some." *Compare* Div. Ex. 155 *with* Flannery Ex. 144.

b. Dismissal of the 10b-5(b) Claim Must Be Summarily Affirmed.

The Division brought claims based on the August 2 letter under Section 10(b) of the Exchange Act and Rule 10b-5, as well as claims under Section 17(a) of the Securities Act. The Division has not petitioned for review of its Rule 10b-5(b) claim, and as such, the Initial Decision must be summarily affirmed on that claim. *See* Petition 2 (seeking review of "Rule

10b-5(a) and 10b-5(c)" claims). Indeed, the 10b-5(b) claim arising from the August 2 letter (the only basis for a 10b-5(b) claim advanced by the Division) is no longer viable after *Janus* as a matter of law, as Chief Judge Murray properly found (Initial Decision 53) and the Division concedes.

c. The August 2 Letter Contained No Misstatements or Omissions.

The Division alleged that the letter contained false statements about various transactions reducing risk in LDBF and about LDBF continuing to be average AA in credit quality, and that the letter failed to warn investors of LDBF's subprime exposure, leverage, and redemption activity by other investors. Initial Decision 53-54. As set forth in the Initial Decision, each of the Division's theories is deeply flawed and contradicted by the evidence.

(i) Risk Reduction Statements

Chief Judge Murray carefully rejected the Division's contention that the risk reduction statements in the letter were inaccurate, finding that:

> The evidence is that the statements in the August 2 letter about risk reduction were true. There is nothing in the record that contradicts Flannery's sworn testimony that on August 2, he believed that the LDBF had reduced risk in the portfolio by selling AAA securities. The August 2 letter discussed swap transactions on July 11-16, the sale of AAA-rated bonds on July 26, and the expiration of TRS [total return swaps] at the beginning of August. According to expert testimony, these transactions reduced the LDBF's portfolio, market and credit risk.

Id. at 53. These findings are supported by the ***unrebutted testimony*** of Respondents' expert, Ezra Zask, who opined that the transactions described in the August 2 letter "reduced the fund's market and credit risk by (1) decreasing exposure to the subprime residential market; (2) reducing the portfolio['s] leverage; and (2) increasing liquidity by converting securities into cash and cash equivalents." *Id.* at 37. Indeed, the Division offered no expert opinion or other

testimony regarding the impact of these transactions on risk in LDBF. More specifically, Chief Judge Murray found:

1. "Between July 11-16, 2007, LDBF reduced its net position in AA ABX swaps by over 90% and reduced its position in BBB ABX swaps by over 25%. The net effect reduced risk of loss from the subprime residential market." *Id.* at 14. The Division offered no contrary evidence.

2. With respect to the July 26 AAA bond sale, it is undisputed that the bonds were leveraged, and $1.1 billion of the sale proceeds were used to pay off that debt, thus reducing risk in LDBF. *Id.* at 16; *see also* Tr. 2356-57 (Zask). Chief Judge Murray also properly rejected the Division's assertion that the AAA sale was done solely to meet redemptions and that the cash raised was gone by August 2, finding that, contrary to the incorrect conclusion of Division expert Russell Wermers that there was essentially "zero" cash left by August 2 (Div. Ex. 255 ¶ 48), approximately $200 million of cash and cash equivalents remained in LDBF. Initial Decision 54.

3. Finally, SSgA allowed total return swaps to roll off the portfolio on August 1, 2007, also reducing risk. *Id.* at 32. Chief Judge Murray noted that Division expert Wermers, who admittedly did not even engage in a risk analysis (Tr. 716-18), "***did not consider LDBF's large risk exposure in TRS*** . . . ." Initial Decision 32 (emphasis added).

(ii) Credit Quality Statements

Chief Judge Murray further found that the letter's language that LDBF continued to be average AA credit quality was true — language the Division itself conceded was (1) "technically accurate," and (2) believed by Flannery to be true. *Id.* at 54. She also found that that the "Division failed to establish that Flannery drafted the language, and, in fact, the evidence suggests otherwise." *Id.* The credit quality language simply is not a basis for a claim.

(iii) Alleged Omissions

Chief Judge Murray properly found that there was no attempt to hide actual and expected redemption activity from investors (*id.*), information widely available to clients in sources such as SSgA's Frequently Asked Questions document ("FAQs"), which Flannery understood Relationship Managers were using to communicate with clients. Div. Ex. 153; Tr. 1310. Similarly, Chief Judge Murray found that information regarding LDBF's subprime exposure and leverage was widely available. For example, a July 25 investor publication reported that LDBF was invested mostly in subprime, used derivatives (i.e., leverage), and had sustained "terrible" losses in July. Initial Decision 14. Further, use of "leverage was authorized in the LDBF's governing documents and leverage information was available in the audited financials and from Relationship Managers." *Id.* at 52. Nothing about this information was "difficult to decipher" (Petition 8) and the Division did not offer any contrary proof.

(iv) Alleged "Targeted" Information to Advisory Groups and Related Funds

The Division repeatedly asserts that advisory groups controlled by SSgA (GAA, OFA and CAM) and other SSgA funds invested in LDBF (the "Related Funds") received "targeted" information allowing them to redeem their investments in LDBF earlier than others. Petition 3. The Division's claims are completely unsupported by the record: there is no evidence that superior information was provided to the advisory groups or the Related Funds — ***none***. Representatives of both GAA and OFA (the Division did not call a CAM representative) testified that they never received preferential information from Flannery or anyone else, and that they recommended redemption due to LDBF's performance; they had no information about actual or anticipated redemption activity by others. Initial Decision 17-18; *see also* Tr. 1809, 2033-34. This testimony was unrebutted. With respect to the Related Funds, there similarly is no evidence

whatsoever that they received "targeted" information. Moreover, these funds redeemed on an in-kind basis rather than for cash, and most such redemptions occurred *after* August 2. Div. Exs. 229, 231; Flannery Post-Hearing. Mem. 54-57; Flannery Post-Hearing Reply Mem. 15-16. In-kind redemptions reflected a decision to *remain exposed* to the LDBF strategy rather than to exit it, a fact which the Division's expert, Wermers, ignored. As Wermers admitted, in-kind redemptions do not require any sale of securities and do not affect the cash available to fund other investors' redemptions. Tr. 672-75, 689; *see also* n.4, *infra*.

Finally, it is notable that the Division wildly asserts that "[t]he factual record revealed that most other LDBF investors were lulled by Hopkins and Flannery's course of conduct to remain in LDBF" and that "Respondents did not call any witness to testify about what they were aware of . . . ." Petition 8. But the *Division* bore the burden of proof, not Respondents, and the *Division* failed to call a single witness to testify that he or she was misled by the any letter with which Flannery was charged. Chief Judge Murray's findings that the August 2 letter contained no misrepresentations or omissions should be affirmed.

d. Flannery Lacked *Scienter* and Was Not Negligent.

Chief Judge Murray also properly found that Flannery lacked scienter and was not negligent. Initial Decision 54 n.88. Indeed, the Division conceded that Flannery believed risk had been reduced when he edited the August 2 letter. Div. Proposed Findings of Fact ¶ 368. Chief Judge Murray found:

- "[T]here is nothing in all the numerous e-mails that supports a claim that Flannery was attempting to obfuscate or mislead. The evidence supports a finding that Flannery's edits to the August 2 letter were intended to make it more accurate, not less so. He suggested adding language to the 'Actions Taken' section of that letter which would have acknowledged more

specifically 'some deterioration in longer-term fundamentals' — an edit that was not accepted or incorporated into the final August 2 letter." Initial Decision 54.

- "There is nothing in the record that contradicts Flannery's sworn testimony that on August 2, he believed that the LDBF had reduced risk in the portfolio by selling AAA securities" (a belief that was true, as discussed above). *Id.* "Flannery knew on the day of the [July 26 AAA] sale or shortly after, that approximately $1.1 billion from the AAA-rated bond sale was used to pay off related repurchase agreements and therefore decreased LDBF's leverage." *Id.* at 16.

- "The evidence also supports a finding that Flannery made no attempt to hide the LDBF's redemption activity." In fact, "[Larry] Carlson, [Nick] Mavro, and [Staci] Reardon were in Relationship Management and had the best information about possible redemptions, and they, along with Consultant Relations, knew that GAA and OFM[sic] were recommending that their clients redeem. All of these people were involved in reviewing the August 2 letter, thus it seems unlikely that Flannery intended to use the August 2 letter to keep people invested in LDBF." Initial Decision 54. Legal also reviewed the letter, and the lawyers were equipped with all relevant information, including that concerning actual and possible redemptions. *Id.* at 27-28; *see also* Tr. 1343-44, 1269-70, 2692-97; Div. Ex. 153.

- The Division's "motivations" expert, William Lyons, "***did not opine on whether Flannery acted improperly*** because" he was motivated to keep investors in LDBF, as the Division theorized. Initial Decision 31 (emphasis added). However, he did opine on cross-examination that "the creation of LDBF II, which was damaging to Flannery's reputation, was an extreme step done to remedy as much as possible an exceptional situation." *Id.* at 32. LDBF II was an alternative fund, *advocated by Flannery*, that provided a way for clients to remain

exposed to the LDBF strategy without being affected by other clients' redemptions; LDBF II, unlike LDBF, would not allow for the daily withdrawals. Tr. 1287-88, 1293-95, 1358-60. LDBF II was being developed when the August 2 letter was circulated and was announced on August 6. Initial Decision 32 n.46. LDBF II clearly shows that Flannery sought to do what was right for investors, regardless of his reputation.

In sum, Flannery's role in the August 2 letter was limited to one round of "suggested edits," only five words of which survived. He reasonably believed the truth of the risk reduction statements (which he did not draft) in the letter. He knew the letter was being heavily edited by others, including SSgA lawyers, who were fully informed of the facts. Chief Judge Murray's conclusion that he did not intend to defraud, and was not reckless or negligent, should be affirmed.

2. The August 14 Letter

The Division brought claims against Flannery arising from the August 14 letter under Section 17(a)(2) and (a)(3) of the Securities Act. Dismissal of these claims should also be affirmed.

a. Background

Flannery offered to write the August 14 letter (the only letter he drafted and signed) over the initial objections of his boss, who asked why he would "raise [his] head up." Initial Decision 30. While "Flannery's duties did not include client communications, . . . he took the initiative to write a letter to clients in August 2007 because he believed investors needed an explanation and it was the right thing to do." *Id.* Flannery testified that:

> Instead of everyone sort of scurrying around and, you know, answering in bits and pieces, I felt like somebody needed to stand up and raise their hand and say: It's me. It stops with me. And so I just felt very strongly about that.

Tr. 1378-80. The negative situation facing LDBF had been widely reported in the financial press by this time (Initial Decision 14), and Flannery's draft similarly detailed LDBF's unprecedented negative returns, weakening fundamentals, and the extreme nature of the situation. Div. Ex. 165. His draft also stated, "[w]hile we will continue to liquidate assets for our clients when they demand it, our advice is to hold the positions for now." *Id.* Deputy General Counsel Mark Duggan revised that sentence to read:

> While we will continue to liquidate assets for our clients when they demand it, we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come.

Initial Decision 30; Div. Ex. 166 (emphasis added). This language, authored by a knowledgeable and experienced SSgA lawyer, is the sole basis for the Division's claim against Flannery.

Numerous people reviewed the letter, including senior members of Relationship Management and Consultant Relations, the President and CEO of SSgA, the Head of Product Engineering, the Chief Marketing Officer, State Street's Director of Media Relations, outside counsel, General Counsel Shames, and, of course, Duggan. Initial Decision 30. Duggan in fact reviewed the letter so many times that, towards the end of the editing process, he wrote to Flannery: **"How many times do we have to sign off???"** Flannery Ex. 207 (emphasis added).

b. Everyone Agrees Flannery "Made a Statement" in the August 14 Letter.

Chief Judge Murray's application of *Janus* in the context of the August 14 letter is irrelevant, because she found (and Flannery conceded) that he made a statement for purposes of this letter.

c. The August 14 Letter Contained No Misstatements or Omissions.

Chief Judge Murray properly found that the August 14 letter contained no misrepresentations or omissions. She found that Flannery believed that many judicious investors

would hold their positions. Initial Decision 31, 56. The evidence of Flannery's belief is unrebutted. "His conclusion was based on the Management Team's belief that subprime securities would recover, the conventional wisdom that you do not want to demand liquidity when the market does not want to offer it, and the fact that none of the bonds in the LDBF portfolio had been downgraded and continued to pay interest." Initial Decision 56. The expert testimony of Erik Sirri corroborated Flannery's belief. *Id.* Furthermore, the "judicious investors" language was consistent with the views held by many sophisticated market participants, even long after the August 14 letter. *See, e.g.*, Hopkins Ex. 161 ¶ 79 (Managing Director of IMF stated belief that "liquidity conditions will return to normal"). Members of SSgA's Fixed Income team also held this view. Initial Decision 56. Moreover, the *very same* "many judicious investors" language was used by Flannery's boss, SSgA's president, in a letter to clients almost two months later (a letter that was not the subject of any enforcement action). *Id.*

Many judicious investors did, in fact, hold their positions, as Flannery believed. For example, as discussed above, SSgA's Related Funds redeemed from LDBF on an *in-kind* basis, reflecting a decision to remain exposed to the strategy.[4] The redemption recommendations of SSgA advisory groups OFA, CAM and GAA (whose recommendation had been disclosed weeks earlier both to clients and to Duggan and others who reviewed the letter, Initial Decision 31, 56) were not inconsistent with the "judicious investors" language — the letter referred to "many" not "all" judicious investors. *Id.* at 56 n.91. And the suggestion that there was any attempt to hide

[4] The Division continues to either misstate or misunderstand the import of the Related Funds' in-kind redemptions, suggesting such redemptions were contradictory to the "many judicious investors" language, and that they drained cash from LDBF. *See, e.g.*, Div. Pre-Hearing Br. 20. But these redemptions reflected a desire by these funds to remain exposed to the LDBF strategy, did not affect LDBF's cash balance, had no impact on liquidity for other investors, and required no cash to be raised at all, as the Division's expert admitted. Tr. 672-75, 689.

actual or anticipated redemptions from investors in August 2007 is contrary to even the most obvious evidence: the language of the very sentence the Division challenges makes it abundantly clear that redemptions were occurring, stating that SSgA "will **continue to liquidate** assets for our clients when the demand it . . . ." Div. Ex. 176 (emphasis added).

d. Flannery Was Not Negligent.

Chief Judge Murray found:

> **The evidence is also conclusive that Flannery was not negligent in connection with his authoring of the August 14 letter**. He believed in the truthfulness of the "judicious investors" language; the statement itself was reasonable, and Flannery reasonably relied on the review of other knowledgeable persons within the SSgA organization, including Duggan and Legal.

Initial Decision 57 (emphasis added).

Flannery reasonably believed the "judicious investors" language added by Duggan was accurate. Investors act differently depending on their objectives and risk tolerances, and not a single person who reviewed the letter found the statement objectionable. *Id.* at 31. Further, "Flannery consistently required that the legal department approve communications to clients." *Id.* Indeed, Flannery circulated the letter widely for review, and received feedback from numerous knowledgeable people in Relationship Management, Consultant Relations, and Legal:

> Flannery's testimony that he 'wanted to make sure that everybody had a crack at it and felt it was okay,' is not in dispute. There is also no evidence that anyone who reviewed the letter told Flannery that anything in it was false, or that additional information should be included to make it not misleading. At the time Duggan edited the August 14 letter, he was aware of GAA's recommendation that its clients redeem from the LDBF. OFA's recommendation had also been communicated to Legal by July 27, 2007. Flannery had worked with Duggan for eleven years and accepted his "many judicious investors" language because he knew it to be true and he respected Duggan's ability.

Id. at 56. Duggan had all the relevant facts when he edited the August 14 letter, including through his review of the FAQs which contained the relevant information including GAA's redemption recommendation; his attendance at the July 25 Investment Committee meeting

(where possible redemptions and liquidity concerns were discussed) at Flannery's invitation; and his discussion with Flannery before the meeting. *Id.* "With this background, it is clear that Duggan was aware of the problems facing LDBF." *Id.* at 56-57.

Chief Judge Murray's finding that Flannery was not negligent is fully supported by the weight of the evidence. On this basis alone, the Commission should affirm her determination that Flannery is not liable in connection with the August 14 letter.

C. The Commission Should Summarily Affirm Chief Judge Murray's Initial Decision Regarding Allegations First Advanced in the Division's Post-Hearing Briefs.

After over three years of investigating and preparing its case against Flannery, the Division in its OIP made no specific allegations of wrongdoing against him in connection with a letter SSgA sent to investors on July 26, 2007, or in connection with the July 25, 2007 SSgA Investment Committee meeting. Evidently, after finally recognizing the lack of evidence supporting its original theories against Flannery premised on the August 2 and August 14 letters, for the first time in its post-hearing briefs, the Division advanced allegations against Flannery concerning the July 26 letter and the Investment Committee meeting, claiming that they amounted to a "scheme to defraud" and a fraudulent "course of conduct." Such belated argument is patently improper. An OIP must "set forth the ***factual and legal basis*** alleged . . . ***in such detail as will permit a specific response*** thereto." 17 C.F.R. § 201.200(b)(3) (emphases added); *see also Jaffe & Co. v. SEC*, 446 F.2d 387, 394 (2d Cir. 1971) (partially vacating order of Commission where OIP failed to provide fair notice of claims).

In any event, Chief Judge Murray rejected the Division's purported scheme liability/course of conduct claims, finding, with overwhelming support in the case law,[5] that this case concerned alleged misstatements and omissions alone, and the Division had demonstrated none. "Because I find there were no materially false or misleading statements or omissions, there can also be no fraudulent 'course of conduct' or 'scheme liability.'" Initial Decision 57.

1. The July 26 Letter

As with the August letters, Chief Judge Murray's findings concerning *Janus* and investor sophistication are irrelevant in light of her other findings in connection with the July 26 letter.

a. Background

Nick Mavro, a V.P. in Consultant Relations, drafted the July 26 letter, the purpose of which was to update clients and consultants on the subprime market and SSgA's strategies, including LDBF, and to explain LDBF's June underperformance. Initial Decision 25, 50. The letter went through an extensive review process involving numerous knowledgeable people within SSgA, and Flannery only made a "couple of edits" each of which made the letter more accurate. Div. Ex. 103; Tr. 937, Initial Decision 25-26, 50 ("The letter went through numerous iterations in which it was revised, additions made, and approvals given by a variety of people who were members of SSgA's legal, investment, and client relations teams."). Consistent with his approach to the August letters, Flannery indicated that he wanted Legal to review the draft of the July 26 letter. Initial Decision 25. Legal, including General Counsel Shames as well as

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[5] *See Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 177 (2d Cir. 2005) (claims under Rule 10b-5(a) and (c) failed where sole basis for such claims were alleged misrepresentations or omissions) (citing *Schnell v. Conseco, Inc.*, 43 F. Supp. 2d 438, 447-48 (S.D.N.Y. 1999)); *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 475 (S.D.N.Y. 2005). The same is true for cases alleging a fraudulent course of conduct under Section 17(a)(1) and (3). *United States v. Naftalin*, 441 U.S. 768, 774 (1979) ("each subsection [of § 17(a)] proscribes a distinct category of misconduct").

outside counsel, reviewed the draft. *Id.* at 25-26. Flannery's name did not appear on the letter sent to clients, and he did not receive a copy of the final letter. *Id.* at 26.

b. The July 26 Letter Contained No Misstatements or Omissions.

While this is not a control person liability case, the Division belatedly asserted that Flannery played "an oversight role" in connection with the July 26 letter, and thus was responsible for its alleged misstatements and omissions. Div. Post-Hearing Br. 39. The Division claimed the letter was misleading because of its emphasis on risk reduction in this statement: "We have been seeking to reduce risk in those portfolios where we believe it is appropriate by taking advantage of liquidity in the market when it exists, and will continue to do so, while seeking to avoid putting undue pressure on asset valuations." Initial Decision 51. Further, the Division contended the letter improperly omitted information regarding LDBF's subprime exposure and leverage, and that LDBF's highest-rated assets were allegedly being sold to fund redemptions. *Id.* at 50.

Chief Judge Murray found that "[t]here is no evidence that any statement in the July 26 letter, including the 'key' statement about the LDBF's efforts to reduce risk, was false." *Id.* at 51. For one thing, she found that the letter was accurate because risk had been reduced by mid-July transactions reducing exposure to ABX swaps. *Id.* at 14. This fact is uncontroverted. Moreover, she correctly found that until August, the Fixed Income Team believed that the fundamentals of the housing market would recover, a belief corroborated by the expert testimony of Erik Sirri. "**Unrefuted** expert testimony established that it was reasonable to believe in August 2007 [after the July 26 letter was sent], that highly-rated structured securities in the LDBF portfolio could eventually recover and become more liquid. It is with the benefit of hindsight that the Division believes it was incumbent on Flannery and Hopkins to warn investors

of something that the evidence shows they were unaware of at the time – the vulnerability of AA and AAA-rated subprime bonds." Initial Decision 51 (emphasis added).

With respect to alleged omissions regarding subprime exposure and leverage, Chief Judge Murray found that this information was already part of the total mix of information available to investors. As Flannery was aware, information about LDBF's subprime exposure was available in the financial press. *Id.* at 14, 52; Tr. 1306-08. Flannery also knew that the information was available in a February CAR Alert sent to investors and in the FAQs, which discussed LDBF's subprime exposure extensively. Tr. 1216-17, 1309-10. Further, "there has been no showing that the LDBF's use of leverage was hidden; leverage was authorized in the LDBF's governing documents and leverage information was available in the audited financials and from Relationship Managers." Initial Decision 52. Indeed, investors "could have obtained the information from their Relationship Managers as SSgA often invited them to do," and they did, in fact, obtain the information. *Id.* at 34, 52. The suggestion that LDBF's subprime exposure and leverage were concealed is flatly contradicted by the evidence.

Regarding the Division's claim that the July 26 letter omitted that LDBF's highest rated assets were being sold to fund redemptions by the Related Funds and GAA and OFA clients, the fundamental premise is wrong: the July 26 AAA sale was done to raise liquidity in a way that would maintain the fund's risk profile; nobody could predict the amount and timing of possible redemptions, and, according to the unrebutted testimony of Division witness Robert Pickett, LDBF's Portfolio Manager, the goal was to treat all investors equally. *Id.* at 16. Moreover, regardless of the reason for the AAA sale, Chief Judge Murray found that: (1) "the July 26 letter was weeks in preparation; while the Investment Committee's decision, a matter of business judgment, was made on or about July 25"; (2) redemption requests were confidential, and

indeed, "[p]ersons from OFA and GAA gave credible testimony that their redemption decisions were independent and confidential"; (3) the letter's purpose was to explain LDBF's past performance; and (4) even accepting for argument's sake the Division's expert's analysis regarding redemptions by the Related funds (a totally flawed analysis, because he ignored the fact that most of them redeemed "in kind" rather than for cash), "[n]othing in this voluminous record shows any actions by Flannery or Hopkins that contributed to that fact." *Id.* at 52.

c. Flannery Lacked *Scienter* and Was Not Negligent.

Flannery did not author the July 26 letter, decide on its final wording, sign it, authorize its distribution or receive a final copy of the letter. Initial Decision 50. He was among numerous people, including high-ranking Client Relations, Consultant Relations, Fixed Income, and Legal Department personnel, who provided comments on the letter, and the suggestion that Flannery "played an oversight" role in connection with the letter is clearly contradicted by the evidence, as Chief Judge Murray found. *Id.* In fact, it was Flannery who wanted Legal to review the letter. *Id.* at 51. "The unambiguous evidence is that Flannery deferred to the wording offered by the legal department, and that Legal, particularly Duggan [Deputy General Counsel] and Shames [General Counsel], were involved deeply in the letter's contents and approved its issuance." *Id.* Finally, as discussed above, Flannery believed that the housing market would recover, and this belief was was reasonable, as it was held by other members of the Fixed Income team, and is supported by unrefuted expert testimony. *Id.* at 51-52.

2. The Investment Committee Meeting

As Chief Judge Murray found, this is a case about alleged misrepresentations and omissions, and there were none. To the extent the Division purports to press its assertion, advanced for the first time in its post-hearing briefs, that the July 25 Investment Committee meeting somehow supports a fraudulent scheme/course of conduct claim, the Division is wrong.

The Division's novel allegation that a decision was made at the meeting to "loot" LDBF (Div. Post-Hearing Br. 67) is false, and lacks any record support.

Because the Chair and Vice Chair of the Investment Committee were absent on July 25, Flannery chaired the meeting. Initial Decision 15. He invited Deputy G.C. Duggan to attend "because he considered the situation facing SSgA to be unprecedented." *Id.* Flannery briefed Duggan on the issues before the meeting, and he also invited key members of the Fixed Income team and Risk Management to the meeting. Flannery Post-Hearing Mem. 27. At the meeting, Flannery raised LDBF's performance issues to the attention of the Committee, encouraged debate, and ensured that the key issues facing LDBF were discussed. *Id.* at 27-31. Robust discussion occurred with active participation by the attendees, including Duggan. *Id.*

Chief Judge Murray found that the Committee instructed the portfolio management team to increase liquidity in LDBF by month end in anticipation of expected withdrawals, sell a pro-rata share across capital structures of the LDBF portfolio, and reduce AA exposure by a target of 5%. Initial Decision 15. However, "[t]he Investment Committee struggled to establish with certainty a percentage of expected redemptions." *Id.* at 16. The instructions were to raise liquidity in a way that would maintain LDBF's risk profile, but the Committee "knew it could not control what the portfolio managers and traders could accomplish in the chaotic, illiquid market, and that the task could not be accomplished with precision." *Id.* "Flannery deferred to the Management Team on how best to accomplish the Investment Committee's directions." *Id.*

The Investment Committee meeting reflected a sincere effort by Flannery and the others present to do what was in the best interests of all clients in the midst of unprecedented market conditions, not a fraudulent scheme. Again, as Portfolio Manager Pickett (called by the

Division) testified: "I think the goal was to treat all shareholders as equal as possible." Tr. 1751-52. Not a single witness contradicted this testimony.

III. CONCLUSION

The Commission should summarily affirm Chief Judge Murray's Initial Decision. At a minimum, the Commission should affirm the finding that Flannery is not liable in connection with any of the Division's claims, excepting from its order the conclusions of law concerning the scope of *Janus* and investor sophistication.

Respectfully Submitted,

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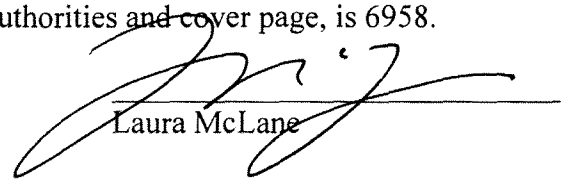
Certification Pursuant to Rule 154(c)

I hereby certify that this motion complies with Commission Rule of Practice 154(c), as the word count of the motion (as calculated by the word count feature of Microsoft Word), exclusive of the table of contents, table of authorities and cover page, is 6958.



Laura McLane