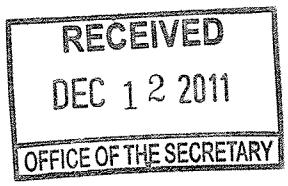
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of **JOHN P. FLANNERY, AND JAMES D. HOPKINS** **Respondents.**	**ADMINISTRATIVE PROCEEDING** **File No. 3-14081**



RESPONDENT JAMES D. HOPKINS' MOTION FOR SUMMARY AFFIRMANCE

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Dated: December 9, 2011

I. Introduction

"The Commission may grant summary affirmance if it finds that no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument." Rule 411(e)(2). "Summary affirmance provides a potentially useful mechanism to resolve quickly certain cases." 60 Fed. Reg. 32738, at * 32775 (Revision Comment *e* to Rule 411). A prompt resolution is essential here; anything else would be a waste of agency resources and unfair to Mr. Hopkins and Mr. Flannery. It is no exaggeration to say that Mr. Hopkins' life was upended by the charges against him. He lost his job and any meaningful possibility of alternative employment in his chosen field, and was forced to endure the arduous process of litigating flagrant accusations about his personal integrity. The Initial Decision vindicated him completely, finding no basis for the Division of Enforcement's (the "Division") charges. With his reputation restored, Mr. Hopkins was ready to put his career back on track as well. Full-blown review of the Division's Petition for Review of Initial Decision (the "Petition"), however, will postpone that opportunity for many additional months. There is no justification for such a delay.

In her Initial Decision, the Chief ALJ analyzed the subprime market crisis, evaluated the specific knowledge and actions of the Respondents with respect to this crisis, and ultimately decided every material element of every claim in favor of Mr. Hopkins (and Mr. Flannery as well). The Chief ALJ's well-reasoned, clear and correct decision was based on 11 days of personal observation of 19 witnesses, her consideration of more than 500 exhibits, approximately 450 pages of post-hearing briefs, and letters by the parties. All relevant factual and legal issues were thoroughly aired, argued and decided. The Petition for Review points to no evidence suggesting that any of them were decided incorrectly, or that any alleged error could possibly affect the just outcome of this proceeding. Having failed to make any showing that the Initial

Decision embodies a finding or conclusion of material fact or conclusion of law that is erroneous or an "exercise of discretion or decision of law or policy that is important," the Commision should exercise its discretion pursuant to Rule 411(b)(2)(ii) and deny the Petition. The Initial Decision in Mr. Hopkins' favor should be summarily affirmed for at least three reasons.

First, the Petition's primary legal argument is moot. The application of *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296 (2011) is of no consequence because the Chief ALJ grounded her decision firmly in independently viable findings that *none* of the statements and omissions attributed to Mr. Hopkins and Mr. Flannery were materially untrue or misleading.

Second, with respect to those dispositive findings, the Petition constructs and attacks a straw man, taking a factor that played no more than a supporting role in some aspects of the Initial Decision and portraying it as the star of the analytical show. The Petition claims that the Chief ALJ created a standard "that would make it impossible for the Division to prove fraud in a context involving highly sophisticated investors" (Petition at 7), and that her reliance on investor sophistication caused her to erroneously import a "reliance" element into the Division's cause of action. (Petition at 8). She did not. The record shows, rather, that the Chief ALJ assessed the *materiality* of the alleged omissions and misstatements "under all the circumstances," *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), and that she *occasionally* referred to investor sophistication as *one* of the relevant circumstances. This was completely appropriate. It was, moreover, functionally superfluous: the Petition obscures the fact that sophistication was never the deciding factor with respect to any of the statements at issue, and sometimes was not a factor at all. The Commission could ignore every reference to "investor sophistication" in the Initial Decision and not find any reason to disturb the Chief ALJ's conclusions.

Finally, summary affirmance is appropriate here because the Petition fails even to mention a third, independent basis for the Initial Decision: the Chief ALJ's findings that, with respect to each of the alleged misstatements or omissions, the Division either failed to prove falsity or presented "no persuasive evidence" of a culpable state of mind. To be sure, the Chief ALJ did not spill much ink on the latter issue, reasoning that her other findings "obviate the need to address Hopkins' scienter or negligence." (Initial Decision at 45). Nevertheless, two facts remain: (1) with respect to *each* of the alleged misstatements and omissions, the Initial Decision contains a specific finding which rejects the Division's evidence on an essential element of its case, and (2) the Petition does not challenge these findings. Even if the Commission assumes that the Petition is correct about the application of *Janus Capital*, and gives the outlandish "sophistication" theory the benefit of considerable doubt, the Initial Decision will stand. Full-blown consideration of the Petition would therefore only waste the Commission's resources and cause a damaging and unfair postponement of Mr. Hopkins' inevitable vindication.

II. *Janus Capital* Is Irrelevant To The Outcome Of This Proceeding.

Although Mr. Hopkins is prepared to show that the Chief ALJ correctly interpreted and applied *Janus Capital Group*, consideration of the issue by the Commission is unnecessary because the Petition's argument with respect to that decision (Petition at 3-6) is beside the point. Even if the Chief ALJ was wrong about *Janus Capital*, the outcome of this proceeding would not change, because the Initial Decision contains findings which negate one or more other essential elements of the Division's claims – falsehood, materiality and/or culpability – with respect to each of the alleged misstatements and omissions that were attributed to Mr. Hopkins: (1) the fact sheets (Initial Decision at 44-45); (2) the "typical" portfolio slide (Initial Decision at 45-46); (3) client presentations in April and May 2007 (Initial Decision at 47); (4) communications with Mr.

Hammerstein (Initial Decision at 48); (5) the March 2007 letter (Initial Decision at 49); and (6) the July 2007 letter (Initial Decision at 51-52). For reasons stated below, these findings will survive no matter how the Commission might interpret the application of *Janus Capital*, which therefore presents no obstacle to affirmance and no reason for delay.

III. The "Sophistication" Argument Attacks A Straw Man.

On pages 6-9, the Petition spins an elaborate theory out of the Chief ALJ's finding that "[t]he LDBF's investors were sophisticated, institutional investors, most of whom engaged investment consultants to provide investment assistance." (Initial Decision at 40). The Petition argues: (1) that this finding was factually erroneous (Petition at 6-7), (2) that the Chief ALJ's reference to investor sophistication "resulted in the erroneous application of reliance caselaw in the government enforcement context where it does not belong" (Petition at 8-9), and (3) that the Initial Decision thus applied "the standard in such a way that would make it practically impossible for the Division to prove fraud in a context involving highly sophisticated investors." (Petition at 7-8).

This argument is disingenuous. First, the Petition distorts the law when it suggests that the Chief ALJ's finding of investor sophistication could be overturned because there wasn't "any factual evidence that all of LDBF's investors were highly sophisticated." (Petition at 7). This inverts the burden of proof: the Division was required to prove the facts here; Mr. Hopkins and Mr. Flannery had no obligation to disprove them. *Steadman v. SEC*, 450 U.S. 91, 95-96 (1981).The Division failed to present any evidence at all to suggest that any of the LDBF's investors were *not* sophisticated (indeed, it did not call a single investor to testify at the hearing), and the Chief ALJ's finding was otherwise rooted in solid evidentiary ground. (Initial Decision at 3, 4 n.7, 5, 33-34).

Second, and more seriously, the "sophistication" theory rests on a serious distortion of the facts. The Petition gives only one example of how the Chief ALJ's reference to investor sophistication supposedly made it "practically impossible" for the Division to prove its case. On page 7, it recounts the testimony of Mr. Hammerstein, who claimed that in April 2007 Mr. Hopkins told him "that the LDBF's total subprime exposure was 2%" when in fact it was much higher. (Initial Decision at 48). According to the Petition:

> ***Nonetheless***, the Initial Decision ***disregards evidence*** of Hopkins' false statement about LDBF's subprime exposure ***by finding*** that '[t]he evidence is persuasive that the LDBF's sophisticated investors knew or should have known about the LDBF's subprime exposure; they could have obtained the information from their Relationship Managers as SSgA often invited them to.'[1/]

This is untrue. The argument on page 7 of the Petition is a cut-and-paste job, fitting together – without attribution or disclosure – a description of one factual issue (Hammerstein's allegation) and the Chief ALJ's resolution of a completely different issue (the July 26 letter). The result is a false impression – or, rather, two false impressions.[2/] First, the Chief ALJ did not "disregard" Hammerstein's allegation. To the contrary, the Initial Decision addressed Hammerstein's claim in detail, and found that "the weight of the evidence is that Hopkins did not misrepresent the subprime holdings in the LDBF." (Initial Decision at 48).

1/ It is worth noting that, while the last 35 words of this passage appear to quote the Initial Decision (Initial Decision at 52), the Petition does not provide a citation to the page on which the quote originates. Petition at 7. The significance of that omission will be discussed below.

2/ This is not the only misstatement of the record in the Petition. For instance, the Petition claims that "[t]he factual record revealed that most other LDBF investors were lulled by Hopkins or Flannery's course of conduct to remain in LDBF and suffered severe losses as a result." (Petition at 8). The Petition cites no evidence for this assertion, which is flatly untrue. The record could not have revealed what "most other LDBF investors" did, or what (if anything) "lulled" them into doing it, because the Division never called a *single* LDBF investor to testify. The statement, moreover, is contradicted by the Chief ALJ's finding that "[n]othing in this voluminous record shows any actions by Flannery or Hopkins that contributed" to the slower pace of redemptions by outside investors when compared to redemptions by SSgA-related funds. (Initial Decision at 52).

Second, the Chief ALJ most certainly did not dispose of Hammerstein's claim "by finding" that a sophisticated investor, such as Hammerstein, "knew or should have known about the LDBF's subprime exposure." The Petition ignores a lengthy passage in which the Chief ALJ discounted Hammerstein's testimony by finding that his recollection was wrong for two well-supported reasons: (1) Hammerstein's conversation with Mr. Hopkins in April 2007 did not concern the LDBF's total subprime exposure, but rather focused on the Fund's position in one particular investment, which *was* about 2%, and (2) since it was clear that Mr. Hopkins had provided accurate information about the Fund's total subprime exposure to others when asked, the Chief ALJ could see "no reason why Hopkins would mislead Hammerstein and provide others with accurate information." Thus, there may have been "genuine confusion" in the conversation, but there was no misrepresentation. (Initial Decision at 48).

None of this had anything to do with Hammerstein's sophistication or the sophistication of the Fund's investors in general; the Chief ALJ resolved Hammerstein's allegation strictly on the basis of other facts. She did the same with respect to two more of the allegations against Mr. Hopkins, deciding that the client presentations and March 2007 letter contained no material misrepresentations, and made no material omissions, for reasons that had nothing to do with investor sophistication. *See* Initial Decision at 47 (deciding that client presentations did not contain material misrepresentations or omissions without mentioning investor sophistication); 49-50 (same with respect to March 2007 letter). As a matter of common sense, the Chief ALJ could not have used investor sophistication to make the Division's job "practically impossible" with respect to these allegations, since investor sophistication played no role at all in these parts of her Initial Decision.

As noted, the Chief ALJ's finding about what sophisticated investors "knew or should have known about the LDBF's subprime exposure" does not appear anywhere in her discussion of Hammerstein's testimony. (Initial Decision at 48). It comes, rather, from a separate discussion of the July 2007 letter several pages later. (Initial Decision at 52). The Petition's failure to disclose the source of the quote from the Initial Decision, therefore, is a significant omission, because Hammerstein's testimony concerned an allegedly false affirmative statement (that the Fund's subprime exposure was only 2% when it was in fact much higher), while the issue regarding the July 2007 letter was the alleged omission of a disclosure about the Fund's subprime exposure. The Chief ALJ found that this omission was not material for several reasons, among them the fact "that the LDBF's sophisticated investors knew or should have known about the LDBF's subprime exposure. . . ." (Initial Decision at 52).

When she cited this factor, however, the Chief ALJ neither imported a "reliance element" into the matter, nor made it "practically impossible" for the Division to prove its case. She merely decided that the omission of information about the Fund's subprime exposure from the letter was not *material*, in part (but only in part, *see below*) because of the sophistication of the Fund's investors. The Chief ALJ's reasoning here was impeccable: (1) as a matter of law, materiality depends on whether, "under all the circumstances," the omitted fact would have assumed actual significance in the deliberations of a reasonable investor, *TSC Industries, Inc.*, 426 U.S. at 449, and (2) as a matter of fact, the relevant circumstances here included the fact the Fund's investors were sophisticated entities, many of them advised by professional consultants, to whom the Fund's total subprime exposure was already available as part of the "total mix of information," readily accessible from sources such as the clients' relationship managers. *See, e.g., McCormick v. Fund American Co.*, 26 F.3d 869, 879 (9th Cir. 1994) (omitted information

was not materially misleading, "particularly in light of McCormick's considerable sophistication").

Investor sophistication, moreover, was not the only basis on which the Chief ALJ determined that the omission of information about subprime exposure from the July 2007 letter was immaterial. She decided that the letter was not actionable for several reasons in addition to the sophistication of the investors and the availability to them of the "omitted" information. (Initial Decision at 51-52). The Petition does not challenge these findings. The same is true with respect to both of the Chief ALJ's other operative references to investor sophistication; it was a *factor* in her resolution of two additional allegations against Mr. Hopkins, but it was never the sole, determining factor, and the Petition does not challenge the Chief ALJ's other findings. *See* Initial Decision at 44-45 (fact sheets did not contain material misrepresentations for several reasons, including lack of evidence that defining subprime investments as "asset backed securities" was "anything but reasonable, particularly when most investors were sophisticated or had sophisticated consultants advising on their behalf"); *id.* at 46 (typical portfolio slide did not contain material misrepresentations for several reasons, including expert testimony that "no sophisticated investor would rely on this single piece of information").

The "sophistication" argument, therefore, is an attack on a straw man. The Chief ALJ made an entirely supportable finding of fact about the sophistication of the Fund's investors. She *mentioned* their sophistication as a factor in determining the materiality of three alleged misstatements and omissions, but only in the broader context of a searching analysis of all relevant circumstances, and only when sophistication was in fact relevant to materiality. Elsewhere, however, the Chief ALJ decided three allegations against Mr. Hopkins without even mentioning investor sophistication. In no instance, therefore, did she elevate investor

sophistication to the status of a dispositive factor, much less make it "practically impossible" for the Division to prove a fraud claim any time it involves a sophisticated alleged victim.

IV. The Petition Does Not Challenge Dispositive Findings With Respect To Each Of The Allegations Against Mr. Hopkins.

The Division's burden required it, of course, to prove *all* of the elements of its claims against Mr. Hopkins. If it failed to prove even one essential element, then the charge failed along with it, regardless of any other errors that the Chief ALJ might, or might not, have committed.

Summary affirmance is therefore appropriate here because the Petition does not even challenge at least one adverse finding, with respect to at least one essential element, of each of the six factual allegations against Mr. Hopkins.[3/] A culpable state of mind, either scienter or negligence, is an essential element of all the charges. (Initial Decision at 41, 43). The Petition does not mention culpability, much less indicate that the Chief ALJ made any errors in her consideration of that element. Thus, the Petition does not even challenge her findings that: (1) with respect to the fact sheets, "no persuasive evidence that Hopkins conveyed information that he knew, or should have known, was materially false or misleading," (Initial Decision at 45); (2) with respect to the communications with Hammerstein, "no persuasive evidence that Hopkins acted with scienter or negligence," (Initial Decision at 48, n.80); (3) with respect to the March 2007 letter, "no showing that Hopkins acted with scienter or that he acted recklessly," (Initial Decision at 50, n.82); and (4) with respect to the July 2007 letter, "no showing that Flannery or Hopkins acted with scienter or that they acted recklessly." (Initial Decision at 52, n.85).

3/ The Division's resort to a footnote (Petition at 2, n.1) to challenge "all findings" contrary to its Proposed Findings plainly does not satisfy the Division's obligations under the rules to "set forth the *specific* findings and conclusions of the initial decision as to which exception is taken, together with *supporting reasons for each exception.*" Rule 410(b)(emphasis added).

The Chief ALJ found it unnecessary to evaluate Mr. Hopkins' culpability with respect to the typical portfolio slide and client presentations in April and May 2007, but only because she had made other findings – *also unchallenged by the Petition* – that negated another essential element of the Division's case. About the typical slide, the Chief ALJ found that, because the slide purported to show the Fund's "typical" mix of investments, rather than its actual portfolio on any given date, "the evidence does not show that the Typical Portfolio slide was false or materially misleading on its face, or that Hopkins represented that it was the LDBF's actual portfolio composition." (Initial Decision at 46). About the client presentations, the Chief ALJ similarly found that an alleged misstatement was true and that no actionable omission had occurred because the discussions never focused on any subject as to which the "omitted" information might be relevant. (Initial Decision at 47).

These unchallenged findings independently negate at least one essential element of the Division's case with respect to each of the factual allegations against Mr. Hopkins. Consequently, the Petition invites the Commission to engage in a fruitless exercise. Even if the Commission were to agree with every argument in the Petition, the unchallenged findings would remain and the Initial Decision would stand. *Janus Capital* and the "sophistication" theory, in other words, are moot issues here, and pointless argument about moot issues is no justification for a lengthy and expensive adjudicatory process, especially when the prevailing party has waited so long for justice and when the consequences of additional delay are, if anything, more burdensome than the penalties that could have been extracted upon proof of culpable misconduct.

V. Conclusion

No issue raised in the Initial Decision warrants further consideration by the Commission. Even if one assumes, against the heavy weight of law and evidence, that the arguments advanced in the Petition have potential merit, their resolution will not lead to a different result. The Commission should, therefore, grant this motion and summarily affirm the Initial Decision in favor of Mr. Hopkins and Mr. Flannery.

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