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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' OPPOSITION TO THE DIVISION'S BRIEF IN SUPPORT OF ITS PETITION FOR REVIEW

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I. <u>Introduction</u>

The Division of Enforcement claims that it brought charges against James Hopkins for "a series of misleading statements and a fraudulent course of conduct," which supposedly "lulled some of the investors in State Street's [Limited Duration Bond Fund ('the Fund' or 'LDBF')] to remain invested in those funds by misleading them about the funds' exposure to subprime residential mortgage-backed securities. . . ." Division Brief ("Div.Br.") 1. The record, however, shows that – as Gertrude Stein once said about Oakland – "there is no there there." It discloses no misleading statements, no fraudulent course of conduct and no lulled investors. The Division says the statements at issue were misleading because they omitted information about the Fund's subprime exposure, but this information was not material when the statements attributed to Mr. Hopkins were made. If it became material, it did so only months later, when a crisis erupted that virtually nobody in the investment community had foreseen. The case against Mr. Hopkins depends at its core on hindsight.

There was, consequently, no culpable conduct by Mr. Hopkins, who was not "reckless" for missing the approach of a crisis that the entire financial services industry failed to anticipate, including the managers and investment professionals at State Street upon whom he relied for the information he provided to investors. The Division claims that "Hopkins marketed LDBF," Div.Br. 1, but this is an overstatement, to say the least. Mr. Hopkins was a mid-level functionary. As a "product engineer," he was *involved* along with many others in marketing LDBF to prospective investors, but as the Law Judge found – in a series of findings that the Division does not, and cannot, challenge – he did not have a say in how LDBF invested its assets, did not have primary responsibility for client relationships, and did not have authority or control over the contents of the alleged misleading statements.

What Mr. Hopkins *did* have, before the Division mounted and maintained this ill-conceived attack on his integrity, was "an unblemished thirty-five-year career of investment industry experience." Initial Decision ("ID") 8. This action deprived him of that precious asset. Nothing can completely restore it now, but if the Commission affirms the Law Judge's decision, as the record and the law demand it should, it will at least enable Mr. Hopkins to reclaim, once and for all, his reputation for integrity.

II. Standard Of Review: The Division May Not Re-Argue Its Case From Scratch; The Commission's "De Novo" Review Of The Initial Decision Is Limited To The Findings And Conclusions To Which The Division Specifically Took Exception In Its Petition.

The Division misstates the standard of review of the Initial Decision, in large part because it ignores the scope of review under the Commission's rules. The Division's brief creates the impression that the Law Judge was more fact-gatherer than adjudicator, and that the Commission's role here is to build a decision from the ground up rather than to perform a review function. This is incorrect. The standard of review of the Law Judge's conclusions may be "de novo," *see In re Kornman*, Rel. No. 59403, 2009 WL 367635, at *9 n.44 (Feb. 13, 2009), and the Commission may base its own findings "on an independent review of the record," *In re Moskowitz*, Rel. No. 45609, 2002 WL 434524, at *1 (Mar. 21, 2002), but the focus of the proceeding nevertheless *is* the Initial Decision – and more specifically, those aspects of the Initial Decision that the Division has timely and specifically challenged. Catch-all objections to all contrary findings, *see* Petition for Review ("Petition") 2, n.1, are not sufficient. Under the Commission's rules of procedure, "[t]he petition shall set forth the *specific* findings and conclusions of the initial decision as to which exception is taken," 17 C.F.R. §201.410(b) (emphasis added), and "[r]eview by the Commission of an initial decision shall be limited to the issues specified in the petition for review." 17 C.F.R. §201.411(d). The Commission does *not* conduct an "independent review of the record . . . with respect to those findings not challenged on appeal." *In re Moskowitz*, 2002 WL 434524, at *1.

The Division's brief ignores these agenda-setting rules, and ignores as well the parameters of its own Petition, which took exception to only four specific findings and conclusions of the Initial Decision. On the law, the Division contested: (1) the Law Judge's application of *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296 (2011), to claims other than those asserted under Rule 10b-5(b), *see* Petition 3-6, and (2) the Law Judge's supposedly "erroneous application of reliance caselaw in the government enforcement context where it does not belong." *Id.* at 8-9. On the facts, the Division asked for review of: (1) the Law Judge's finding that the Fund's investors were highly sophisticated, *see id.* at 6-7, and (2) her finding that sophisticated investors had access to all relevant information about the Fund. *See id.* at 7-8. The Division did not take exception to any other specific findings or conclusions. The Commission's scheduling order allowed the Division to proceed on those issues, and in addition provided that, "[p]ursuant to Rule of Practice 411(d), the Commission has determined on its own initiative to review what sanctions, if any, are appropriate in this matter." Order Denying Motions For Summary Affirmance, 4.

The Division's argument on the standard of review is also distorted by another important omission. The standard of review of a Law Judge's decision necessarily operates in tandem with the burden of proof applicable to the charges at hand. The Division bore the burden of proving every element of its charges against Mr. Hopkins by a preponderance of the evidence. *See Steadman v. SEC*, 450 U.S. 91, 95-96 (1981). Even where it independently reviews the record, therefore, the Commission must determine not whether the Division can point to *some* evidence for its preferred version of the facts, but whether the Division has shown that the existence of each asserted fact is more probable than its nonexistence. *In re Winship*, 397 U.S. 358, 371-72 (1970). The Division's brief ignores this essential constraint.

III. The Facts

Although the Commission's own rules mandate that the Commission's independent review of the record be limited to the two, sophistication-related factual issues identified in the Petition, the Division's brief goes far beyond those narrow exceptions. It advocates a wholesale revision of the facts that the Commission could accept only by rejecting many of the Law Judge's unchallenged findings. In this section of his brief, Mr. Hopkins will expose several inconsistencies between the record and the Division's version of the "facts." With respect to this corrective account, two basic questions should be kept in mind about the Division's narrative.

Where are the investors? The most notable aspect of the Division's case at the evidentiary hearing was the absence of testimony from even *one* of LDBF's investors or potential investors. Investor involvement, of course, was essential: securities fraud does not occur in a vacuum. The Fund's investors were the entities that Mr. Hopkins supposedly misled; they either would or would not have found the alleged misrepresentations and omissions material to their investment decisions. Even as it disclaims a legal obligation to prove investor reliance in an enforcement matter, the Division recognizes the crucial factual role played by the alleged victims of the alleged misconduct: it repeatedly proclaims that Mr. Hopkins' actions *had* an adverse effect on the Fund's investors. For example, the first sentence of the Division's brief asserts that the Respondents' conduct "lulled some of the investors in State Street's commingled trust funds to remain invested in those funds by misleading them. . . ." Div.Br. 1; *see also id.* at 2 (repeating allegation that respondents "misled many investors to continue to purchase or continue to hold their investments in these funds, resulting in hundreds of millions of dollars of investor losses during the subprime market meltdown"); *id.* at 9 (claiming that "fund investors were misled" by supposed misrepresentation in letter from State Street).

The Division, however, cites no evidence to support these claims, *see id.* at 1, 2, 9, nor could it, because no evidence exists for them. As far as the record discloses, not a single investor was "lulled . . . to remain invested" in LDBF by anything that Mr. Hopkins said or did not say, not a single investor was "misled" into thinking or doing anything, and not a single dollar was lost as a "result[]."

When did the alleged misrepresentations and omissions occur? There is a critical temporal disconnect in the Division's case. The essence of the charge against Mr. Hopkins is that his statements and omissions concealed "the extent of subprime RMBS held in" LDBF's portfolio. Div.Br. 2. The Division alleges that the "resulting" losses occurred "during the subprime market meltdown in mid-2007," *id.*, and argues that the alleged misrepresentations and omissions were material "because [they] concerned exposure to subprime RMBS *during the subprime market crisis*." *Id.* at 27 (emphasis added). The Division admits, though, that LDBF's subprime exposure only "became a crisis in July 2007." *Id.* at 35.

The case against Mr. Hopkins is defective, then, because with one factually and legally inconsequential exception (discussed below in Section III.E.), the charges against Mr. Hopkins concern statements and omissions that occurred no later than May 10, 2007 – no fewer than two months before the subprime crisis began. There is, consequently, a gap between the Division's theory of liability (that concealing LDBF's exposure *during* the subprime market crisis might be actionable) and the facts brought out at trial (that if Mr. Hopkins failed to disclose LDBF's subprime position, he did so only *before* the crisis). This is a fatal disjunction. It means that the

Law Judge was correct when she ruled that the Division had failed to prove the elements of materiality and scienter with respect to any of Mr. Hopkins' alleged misconduct.

A. The Fact Sheets

The Order Instituting Proceedings ("OIP") dwelled extensively on alleged misstatements in the quarterly fact sheets that State Street distributed to investors and prospective investors in LDBF. OIP ¶¶13-14, 18-20. The Law Judge found, however, that the fact sheets did not contain any material misrepresentations. ID 44-45. The Division did not take exception to this finding in its Petition. Nevertheless, the Division's brief presents a counterfactual recitation that ignores the Law Judge's contrary rulings. Not deigning to explain how the Law Judge was wrong, the Division simply insists that its version is right, repeating several contentions that the Law Judge had rejected: (1) that "the fact sheet falsely represented that LDBF was sector diversified," (2) that the fact sheets categorized LDBF's holdings in subprime mortgage backed securities as asset-backed securities (ABS), thus obscuring "that all of this exposure was subprime RMBS," and (3) that "the fact sheets misleadingly concealed the risk of LDBF by omitting LDBF's significant use of leveraged subprime RMBS investments. . . ." Div.Br. 5-6. There is nothing to any of this. The Law Judge's findings were right for the following reasons.

1. Diversification

The fact sheets never said that the "LDBF was sector diversified." Every quarterly iteration of the fact sheet, rather, actually said the same two things about diversification: (1) under the heading "Investment Objective," that the Fund invested in a "diversified portfolio," and (2) under the heading "Risk Management," that the Fund's investment "[s]trategy has better sector diversification" when compared to the typical regulated money market portfolio. Hopkins Ex. ("Hop.Ex.") 1; Division Exhibit ("Div.Ex.") 20; Div.Ex. 29; Div.Ex. 97; Div.Ex. 224.

The Law Judge correctly found that both of those statements were true. First, State Street believed that the LDBF *portfolio* "was diversified, and this belief was reasonable" because the Fund's investments in RMBS securities were not price correlated and because "SSgA took special care to assure" that the underlying assets "varied in terms of credit quality, specific geographic location, individual FICO scores, and loan structures, among other things." ID 44. Second, the Fund's investment *strategy* did have better sector diversification than a typical 2A-7 money market fund because the evidence established, "without contradiction," that "LDBF was a market value fund with an expanded universe from which it could purchase assets." ID 44.

2. Asset-Backed Securities

The Law Judge also recognized that there was nothing deceptive about calling housing-related collateralized instruments asset-backed securities, or "ABS." ID 44-45. State Street simply followed the classification scheme of the Lehman Aggregate Index, which defined ABS in exactly the same way. Tr. 431-32 (Hopkins); Tr. 1591 (Pickett); Hop.Ex. 136. Expert testimony established that describing subprime home equity loans as "ABS" was industry practice. Hop.Ex. 161 ("Sirri Report") ¶¶11, 33-38; Tr. 2074-75 (Sirri). The SEC itself, along with scholars and commentators, credit rating agencies, industry organizations, staffers at the Federal Reserve, and other funds that invested in RMBS – *all* put subprime securities in the ABS "bucket." Sirri Report ¶¶33-38.

3. Leverage

Finally, there is nothing to the Division's contention that "the fact sheets misleadingly concealed the risk of LDBF by omitting LDBF's significant use of leveraged subprime RMBS investments. . . ." Div.Br. 6. The narrative section of the fact sheets disclosed the Fund's use of leverage, noting that the Fund utilized "futures, options, and swaps." *See, e.g.*, Hop.Ex. 1;

Div.Ex. 29. These investments all use leverage, and the Division failed to show that any of the investors in the Fund did not understand the reference. *See, e.g.*, Division's Proposed Findings of Fact ("DFF") ¶¶78-79; Sirri Report ¶¶21-31.

B. The March 2007 Letter

The Fund's strategy was to match or exceed the returns of the JP Morgan US Dollar LIBOR Index. Hop.Ex. 1. In early 2007, the Fund did not meet these expectations. Div.Ex. 46. Several other State Street funds also "underperformed." *Id.* The company's portfolio management team (which did not include Mr. Hopkins) attributed the negative results to the exposure these funds had to the "BBB-ABX," an index of derivative investments in the triple-B rated residential mortgage backed securities sector. Tr. 2853 (Wands).

The securities underlying the BBB-ABX index were backed by "subprime" mortgages, but that wasn't their salient characteristic. What distinguished them, rather, was their position in the lower tranches of the "cash flow waterfall." Sirri Report ¶45. When consumer mortgage loans are bundled into investment vehicles, the various tranches of the security carry different credit ratings (AAA and BBB, for example), and the credit rating of each tranche depends on its place in this hierarchy. *Id.* at ¶47. Payments on the underlying mortgage loans flow first to securities with AAA ratings, then to securities with AA ratings, and so on down to the BBB tranche. *Id.* at ¶45. These securities may all be "subprime investments," in the sense that the source of the cash flow is payments on mortgage loans to "subprime" borrowers, but because the BBB tranche is the last investment grade security in line to receive the cash, it is the first investment grade security in line to bear the consequences of defaults by the mortgage debtors. BBB rated securities, therefore, are riskier than AAA rated securities (and consequently earn a higher return). *Id.* at ¶¶45-46. The truism holds for all rated fixed income securities; the "subprime" label is irrelevant. *See* Hop.Ex. 162.

In early 2007, some hedge funds responded to negative publicity about the subprime housing market by using the BBB-ABX index to go "short" on the American housing market. Div.Ex. 45; Tr. 220 (Hopkins). The speculation caused price spreads to widen on the index, hurting the performance of funds that used the index as a proxy for investing in BBB securities backed by residential mortgages. Div.Ex. 45. LDBF's performance suffered briefly. *Id.* State Street's investment managers, however, did not see any fundamental flaw in the market for subprime-mortgage-backed securities; in particular, they did not believe that February's underperformance, driven by speculation in an index of BBB-rated securities, portended any problem with the future performance of higher-rated, AA and AAA, "subprime" bonds. Tr. 2853-2855 (Wands). And, in fact, the subprime market quickly rebounded, enabling the Fund to outperform expectations in April and May 2007. *Id.*

The Fund *had* underperformed at the beginning of the year, though, and in late February 2007 Mr. Hopkins was asked by his boss, Adele Kohler, to draft a Client At Risk ("CAR") alert about the situation. Div.Ex. 45. This was intended to be a "short write-up" that would "broadly outline the reasons for what has occurred," and "not to present an in-depth treatise of what has happened." Div.Ex. 46. The sources of the information and opinions in the CAR alert were the portfolio managers. Tr. 220 (Hopkins). The CAR alert was drafted, moreover, strictly for internal consumption, and was distributed to State Street employees to enable them to communicate more effectively with investors. Tr. 220-21 (Hopkins).

Mr. Hopkins was then asked to edit the internal CAR alert into a form that could be distributed directly to investors. Hop.Ex. 34. The revision, which became the template for the

March letter, maintained the same focus on specific recent events (the Fund's underperformance) and their specific causes (speculative investment activity in the BBB-ABX index). *Id.*; Div.Ex. 58. The limited scope of the letter was not hidden; Mr. Hopkins' draft announced in its first paragraph that "[t]he purpose of this short write-up is not to present an in-depth treatise of what has happened," but "to broadly outline the reasons for and magnitude of what has occurred, to outline the impact of this on the market generally and on our Funds more specifically and to give a sense of what we are doing as it pertains to this situation and its impact on our portfolios." Div.Ex. 58. And, as was his practice, Mr. Hopkins had the letter reviewed for accuracy by LDBF's investment professionals. *See* Div.Ex. 55; Hop.Ex. 36.

Until the Division filed its appellate brief, there was no dispute that the March letter delivered on its explicit promise. During the proceedings below, the Division never alleged that the letter contained even a single affirmative misstatement. *See* Division Prehearing Brief, 9; OIP ¶22; Division Post-Hearing Brief, 18. The Division's position was so clearly focused on omissions and not misrepresentations that the Law Judge observed in her decision that "[t]he Division does not allege that the March letter contained misrepresentations." ID 49, n.81.

The Law Judge rejected the omission theory, noting that the "alleged omissions go beyond the stated purpose of the March Letter." ID 49. The limited purpose of the letter had been stated in the letter itself: to "outline the reasons for and magnitude of what [had] occurred" with respect to LDBF's performance in January and February 2007. Since the underperformance during those months *had* been caused by the Fund's exposure to the BBB-ABX Index, and since "LDBF's actual BBB ABX exposure of 3% [was] consistent with the March letter's characterization of 'modest exposure,'" there was nothing misleading about the March letter. ID 49-50.

Unable to defend the omission-based charge, the Division has shifted ground. It now claims that the March letter contained an affirmative misrepresentation: "In that letter, Hopkins characterized the exposure of SSgA's active strategies to the subprime home equity market as 'modest,' even though he knew that LDBF was virtually all subprime RMBS." Div.Br. 9. "As a result" of that characterization, the Division now says, "fund investors were misled into thinking that LDBF's BBB-rated ABX investment was its sole exposure to subprime RMBS." *Id.*

Both of these allegations are untrue. The Division knows that the March letter did *not* characterize the Fund's "exposure . . . to the subprime home equity market as 'modest.'" In the OIP, which the Division drafted and issued, it recognized that the letter had addressed only "the Fund's 'modest' position *in the lowest rated tranche of the ABX index*, which represented credit default swaps on 20 different subprime investments rated BBB." OIP ¶22 (emphasis added).

The Division knows, moreover, that it has no basis for claiming that "fund investors were misled" by the March letter "into thinking that LDBF's BBB-rated ABX investment was its sole exposure to subprime RMBS." This is yet another example of the Division's evidence-free approach to all questions of causation. No investors testified, so none could have said that the March letter misled them, and the Division introduced no documentary evidence from which such an inference could possibly be drawn.

C. The "Typical Slide"

The so-called "typical slide" was part of a standard Power Point presentation for clients and prospective clients. Mr. Hopkins occasionally attended presentations where the slide deck was used. The Law Judge found that Mr. Hopkins "did not prepare the PowerPoint presentation and he did not author or have ultimate authority for the Typical Portfolio Slide." ID 45. At most, he "was asked to review and correct material that others prepared," and "was asked to make corrections" to the slides in the presentation. ID 45.

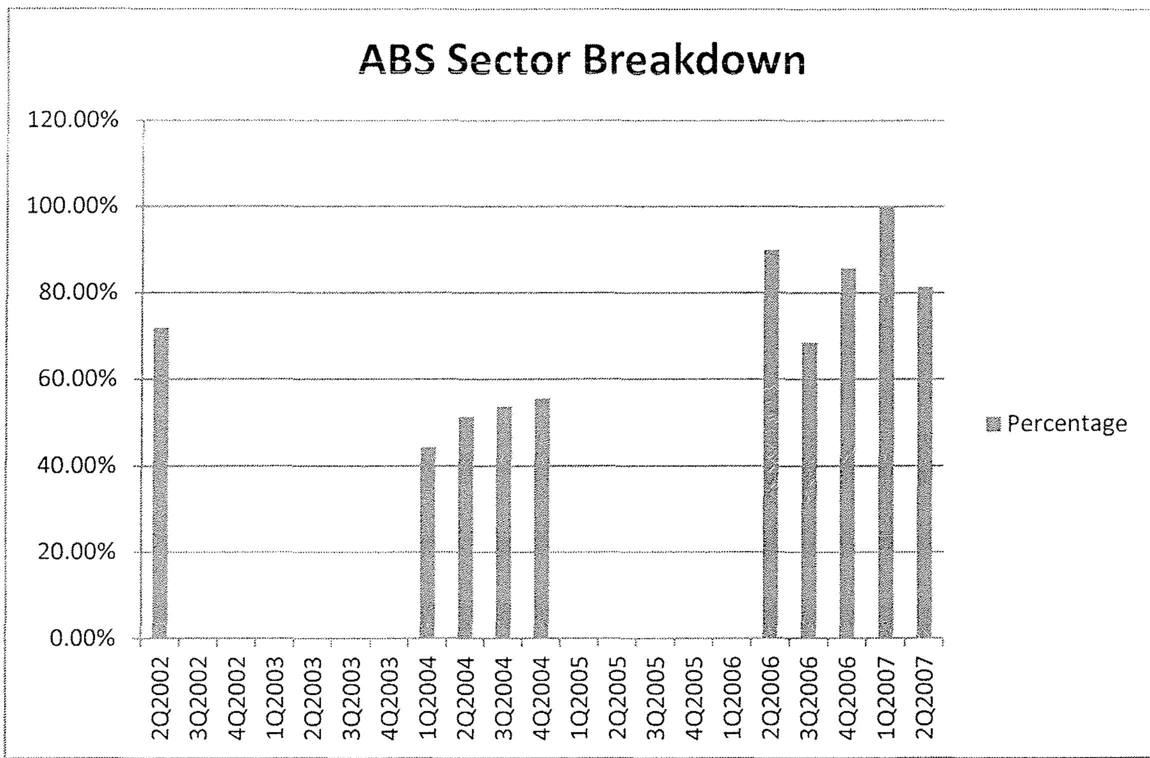
The "typical slide" was entitled "Typical Portfolio Exposures and Characteristics – Limited Duration Bond Strategy." *E.g.*, Div.Ex. 23, p. 12. It contained some text, as well as two bar charts under the heading "Breakdown by market value." *Id.*; OIP ¶¶15-17. The left-hand bar chart, under the sub-heading "By sector," indicated that a "typical" distribution would have 55% of the Fund's portfolio invested in asset-backed securities. *E.g.*, Div.Ex. 23, p. 12.

The Division claimed that this bar chart was misleading in two ways: (1) it "failed to disclose any exposure to subprime investments," because it did not note that "subprime" securities were categorized as asset-backed, and (2) it "also indicated a greater level of sector diversification than actually existed" in 2006 and 2007 because it suggested that the Fund's ABS exposure represented only 55% of its portfolio, when in fact "its actual investments during this time were almost all ABS, of which almost all was subprime ABS." Division Prehearing Brief, 7; OIP ¶¶15-17. The Law Judge rejected this claim, finding that "the disputed page on its face states that it is 'typical.' As its name makes clear, the slide represented a typical portfolio breakdown, not the composition of the LDBF's actual portfolio at a particular point in time. Typical is not actual." ID 46.

The Division did not take exception to this finding in its Petition, but its current brief challenges the Law Judge's rationale, arguing that "[a]lthough the presentation stated that LDBF's 'typical' ABS exposure was 55%, Hopkins knew the fund's actual investments during this time were almost all ABS, and specifically almost all subprime RMBS." Div.Br. 7-8. The Division relies on a chart which shows the Fund's actual sector exposure during four selected quarters in late 2006 and early 2007, when its investment in asset backed securities constituted between 70% and 100% of its portfolio. Div.Br. 8.

The chart, however, merely cherry-picks a small and conveniently favorable set of data about the Fund's portfolio over four calendar quarters in 2006-2007, and insists that the 55% figure is not "typical" because the Fund's ABS exposure was larger than 55% during that slice of time. *See also* Division Post-Hearing Brief, 16; DFF ¶269.

However, the relevant time period for determining the "typical" sector-composition of the Fund is not any-time-period-in-which-the-composition-favors-one-party's-case. Mr. Hopkins could play that game, too. As the chart below demonstrates, there is another set of data in the record about the Fund's composition, and it shows that, for the four quarters of 2004, the portfolio's exposure to ABS hovered almost exactly around the 55% figure.



The Division has not explained why a four-quarter slice of 2006-2007 data, which it emphasized, is a more "typical" sample than a four-quarter slice from 2004, which it ignored.

And, of course, the chart is incomplete, because the Division did nothing at trial to provide data about the Fund's sector weights in most of 2002, all of 2003 and 2005, or the first quarter of 2006. What the graph really shows, therefore, is a failure of proof. The Division had the burden of proving that the slide was inaccurate; Mr. Hopkins did not have to prove its accuracy. But the Division provided no evidence of the Fund's sector allocation for more than *half* the quarters of its existence. With a data set that was as empty as it is full, there was no basis for an objective determination of the Fund's "typical" ABS exposure, and no legitimate basis for a finding that the typical slide was untrue in this respect.[1/]

D. The Phone Call With Yanni Partners

David Hammerstein – a consultant with Yanni Partners who was paid to advise National Jewish Medical and Research Center about its investments – is the only witness who can be said to have interacted with State Street from the "investor side" of the equation. His testimony, moreover, is the only evidence in the record to suggest that Mr. Hopkins ever made an affirmative misrepresentation about the extent of LDBF's subprime exposure: Hammerstein claimed that, during a telephone call with Yanni Partners in April 2007, Mr. Hopkins said that

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1/ The Division asserts that "Hopkins personally presented the Typical Slide to clients on at least five occasions during 2006 and 2007." Div.Br. 7. It has no evidence to support this claim. The evidence it cites shows only that Mr. Hopkins participated in several client presentations during the period in question, but that (1) he did not recall ever showing, discussing or otherwise "personally present[ing]" the "typical slide" to anybody, and (2) there is no extrinsic evidence that he ever did so. *See, e.g.*, Tr. 151-153, 163-164, 170-179, 199-209, 234-235 (Hopkins). The record shows, moreover, that before each presentation in which he took part, Mr. Hopkins took the trouble to check the Fund's actual sector allocations at the time, and to note them in handwriting on his hard copy of the "typical slide." *See, e.g.*, Tr. 150-151, 167, 170, 234-235 (Hopkins); ID 46. If Mr. Hopkins "personally presented the Typical Slide to clients" during these meetings, therefore, it is as likely as not that he also supplied the actual, current sector allocations to his audience.

Elsewhere in its brief, the Division also claims that Mr. Hopkins presented the "typical slide" to investor consultant David Hammerstein and his clients from National Jewish Medical and Research Center at a meeting on May 10, 2007. Div.Br. 10. There is no evidence to corroborate Mr. Hammerstein's oddly-precise recollection – either from others attending the meeting or in documents that reflected what was said there – but his claim is at any rate irrelevant. Even if Mr. Hopkins presented the slide at the meeting, the Law Judge correctly found that the document contained no material misrepresentations.

LDBF's "total exposure to subprime issues is 2 percent," Tr. 2450-51, when in fact the Fund's overall subprime exposure was much higher.

The Law Judge, however, did not credit this testimony. She did not doubt Hammerstein's general sincerity, ID 47, n.78, but she nevertheless rejected his specific claim, finding "genuine confusion" about what was said during the phone call and that "the weight of the evidence is that Hopkins did not misrepresent the subprime holdings in the LDBF." ID 48.

This was at bottom both a credibility determination and a practical application of the burden of proof. The Law Judge rejected the Division's allegation because all of the evidence – aside from Hammerstein's purported recollection – showed that Mr. Hopkins had *not* made the alleged misrepresentation: (1) the Fund's overall subprime exposure was not the subject of his conversation with Yanni Partners in April 2007, (2) the call was in fact about the Fund's exposure to the narrow class of BBB-rated subprime securities that had caused a recent problem with LDBF's performance, (3) the Fund's exposure to the BBB tranche at the time was in the 2% range, as Mr. Hopkins reported, (4) in his dealings with other investors and State Street's client-facing personnel, Mr. Hopkins was never "anything but forthcoming about LDBF's subprime exposure," and (5) there was "no reason why Hopkins would mislead Hammerstein and provide others with accurate information." ID 48.

The Petition *mentions* Hammerstein's account, but only in passing and only in support of its exception to the Law Judge's finding that LDBF's sophisticated investors had access to relevant information; it does not specifically challenge the Law Judge's decision to discredit Hammerstein and to reject the allegation that was based on his account. *See* Petition 7. Even if the Division had properly sought "independent review" with respect to this issue, moreover, the Commission would not be free to disregard the Law Judge's role as primary fact-finder. Rather, "[i]t is well settled that credibility determinations of an initial fact finder are entitled to considerable weight because they are based on hearing the witnesses' testimony and observing their demeanor." *In re Tricarico*, Rel. No. 32356, 1993 WL 183678, at *3 (May 24, 1993). The fact-finder's determinations "can be overcome only where the record contains 'substantial evidence' for doing so." *Id.*; *see also In re Ward*, Rel. No. 47535, 2003 WL 1447865, at *10 (Mar. 19, 2003). In *Ward*, for example, the Commission rejected a finding that the respondent was credible where his testimony was the only evidence supporting his position, and it was "contradicted by overwhelming testimonial and documentary evidence in the record." *In re Ward, 2003 WL 1447865, at *10*; *see also In re Moskowitz*, 2002 WL 434524, at *6 (declining to accept Law Judge's finding where respondent's "self-serving hearing testimony regarding the existence of a subsequent oral agreement was the only evidence of such an agreement and flies in the face of the substantial, contradictory documentary evidence").

Application of the same criteria to the Yanni-State Street phone call in April 2007 could lead the Commission only to *affirm* the Law Judge's finding. Hammerstein's testimony, like the testimony of the respondents in *Ward* and *Moskowitz*, was the only evidence of the alleged misrepresentation, and it flew in the face of substantial, contradictory documentary evidence.[2/] This disparity should be dispositive, because it is clear that Hammerstein himself had no independent "memory" of the phone call – he "remembered" only what a contemporaneous memorandum of that call allowed him to assert. Div.Ex. 69. The Division elicited no testimony from Mr. Hammerstein to suggest that he could independently remember anything that hadn't been written down soon after the fact. Tr. 2429-81 (Hammerstein). The Division cannot have

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[2/] Mr. Hopkins and David Hammerstein were not the only participants in the conversation: several others, from both State Street and Yanni Partners, were on the call. *See* Tr. 2449(Hammerstein); Div.Ex. 69; Div.Ex. 161; Div.Ex. 73; Hop.Ex. 57. Yet the Division elicited no testimony that substantiated Hammerstein's account.

carried its burden of proof, then, if the weight of the documentary evidence indicates that Mr. Hopkins spoke truthfully during the phone call.

It does. The reason for the phone call, like the purpose of the March letter, "was to evaluate the reasons for the fund's cumulative 100 basis point performance shortfall during February and March 2007." Div.Ex. 69. Hammerstein's client, National Jewish, was not invested directly in the Fund; its money was in the State Street Global Advisors' Commodities Fund, but LDBF served "as the collateral for the commodities futures exposures from the swap position." Div.Ex. 69.

There is no question that State Street attributed the Fund's recent underperformance to the behavior of its modest investment in the BBB-ABX index. *See, e.g.*, Div.Ex. 46, 86; Hop.Ex. 34, 135. The March letter was captioned "Triple B Exposure and Impact to SSgA's Limited Duration Bond Fund." The relevant sections of the slide deck used in a presentation to Catholic Healthcare in late April, and of the slides that State Street e-mailed to Yanni Partners a couple of days before a presentation to National Jewish on May 10, were both entitled "Market Review – Triple B Exposure." Hop.Ex. 135; Div.Ex. 78. And, according to National Jewish's Investment Committee Minutes (which Hammerstein vetted for accuracy), Mr. Hopkins said at the May 10 presentation "State Street had just fewer than 3% of BBB sub prime investment exposure…." Hop.Ex. 62.

There is no reason to believe that a telephone call, conducted just a few weeks earlier to evaluate the reasons for the same underperformance, would have focused on anything other than the BBB-ABX index as well. The Division hung its claim, however, on the fact that, in several places throughout his memorandum of the phone call, Hammerstein referred generally to "subprime" issues: (1) noting that State Street had attributed the Fund's underperformance to the collapse in prices for "sub-prime mortgage issues," (2) noting that "[r]ecently, the Fund has a 2.5% position in floating rate notes with sub-prime mortgage exposure," and (3) recording that "[t]he Fund's current exposure to the sub-prime issues is now 2% because it trimmed this exposure slightly to manage risks." Div.Ex. 69. The last two statements would be inaccurate only if they reflected information given by State Street about the Fund's *total* investment in all grades of "subprime" securities; they would be true if they reflected information given by State Street about the Fund's investment in BBB-rated subprime securities alone (which was actually in the 2% range at the time).

The case against Mr. Hopkins therefore depended on assigning retrospective precision to patently imprecise language. Context is important here. In April 2007, "subprime" was not the familiar, effectively-pejorative term that it would later become. Sirri Report ¶41. "[P]rior to the financial crisis of 2007-2008, subprime was merely a technical descriptor of certain assets…[.]" *Id.* It referred to a security backed by mortgage loans given to borrowers with certain credit characteristics. *Id.* The word "subprime" described the credit quality of the underlying assets (the mortgage loans), and not the credit quality of the mortgage-backed security itself. "Subprime" securities could and did (and still do) have high-quality, AA and AAA, credit ratings. *See, e.g.,* Sirri Report ¶¶40, 50, 56. In fact, the vast majority of the Fund's "subprime investments" were of such high quality, with only a small percentage in a BBB tranche. Div.Ex. 69.

Because "subprime" was not a significant descriptor at the time – i.e., because the distinction between a BBB and an AAA security was *much* more significant than the distinction between a "subprime" security and, e.g., a credit-card backed ABS – it is certainly understandable that somebody like Hammerstein (who had not previously assigned any significance to the "sector" diversification of the Fund) might be less than precise when using such descriptors. Indeed, under these circumstances, it would have been natural for Hammerstein to conflate the specific ("BBB subprime") and the generic ("subprime"), and to casually record an accurate, specific statement ("the Fund now has about a 2% position in BBB subprime investments") in inaccurately general terms ("the Fund's current exposure to the sub-prime issues is now 2%").

A contextual reading of Div. Ex. 69 thus reveals that Hammerstein wrote down something that Mr. Hopkins did *not* say on April 9, and that when Hammersein testified, the memory that he reconstructed from the document was wrong as well. Tr. 2448-50 (Hammerstein). The context makes it clear that Mr. Hopkins' remarks *were* focused on the Fund's BBB position, and that when Hammerstein wrote down "sub-prime issues," he was reflecting comments about "BBB subprime" securities alone. For example, consider the following sequence of statements from page 1 of Hammerstein's memo: "The lowest rung of investment grade securities is BBB; the Fund limits BBB exposure to 5%. Recently, the Fund has a 2.5% position in floating rate notes with sub-prime mortgage exposure." Div.Ex. 69, p. 1. The first of these two sentences plainly indicated that Mr. Hopkins had been talking only about BBB investments. *Id.* The second sentence just as plainly referred to the same subject – its evident purpose was to compare the Fund's actual BBB position (2.5%) with its BBB limit (5%). *Id.* Yet in the next sentence Hammerstein used the phrase "sub-prime mortgage exposure" to loosely characterize the same information – in other words, he used "sub-prime mortgage exposure" when he *must* have meant "BBB subprime mortgage exposure." *Id.*

Later, on page 2 of his memorandum, when he noted that "the Fund's current exposure to the sub-prime issues is now 2% because it has trimmed this exposure slightly to manage risks," Hammerstein was obviously referring back to the same information about the same subject, once again comparing apples to apples. Div.Ex. 69. Now the specific subject of comparison was the Fund's *current* exposure (2%), "trimmed" from what had recently been a slightly larger exposure – which could only be its recent 2.5% position in *BBB* subprime securities. *Id.* When Hammerstein used the phrase "sub-prime issues" on the second page of his memorandum, then, he must have been recording Mr. Hopkins' *accurate* report of the Fund's position in BBB securities alone. *Id.*

Evidence about the phone call itself, then, gave the Law Judge ample reason to conclude that the Division had not carried its burden of proving that Mr. Hopkins misrepresented the Fund's total subprime exposure during it. This conclusion was supported, moreover, by evidence concerning extrinsic events which also cast doubt on Hammerstein's account. As the Law Judge observed, there were "no other instances where, when asked, Hopkins is alleged to have been anything but forthcoming about the LDBF's subprime exposure." ID 48. The Law Judge noted one occasion, in June 2007, when Mr. Hopkins "informed a SSgA person gathering information for a consultant that she was mistaken and that approximately 95% of LDBF was in subprime." *Id.* (citing Div.Ex. 96). The Law Judge could also have noted several instances both before and after the April phone call in which Mr. Hopkins was equally forthcoming, providing accurate information about the Fund's subprime exposure (once, in July 2007, to Hammerstein himself), as well as the evidence showing that Mr. Hopkins invariably prepared for client presentations by obtaining, among other things, updated information about the composition of LDBF's portfolio, including the extent of its subprime investments. *See, e.g.*, Tr. 150-151, 234-235 (Hopkins); Div.Ex. 246, p.6-7; Div.Ex. 96; Div.Ex. 121. This evidence justified the Law Judge's finding that there was "no reason why Hopkins would mislead Hammerstein and provide others with accurate information." ID 48.

E. The July 26 Letter

Last, and most certainly least, the Division's brief barely mentions what had once been a major allegation against Mr. Hopkins: his alleged involvement in drafting a letter that State Street sent to LDBF's investors on July 26, 2007. The Division devotes a long section of its facts section to describing what it calls "the course of business continued through client letters that misled investors by understating the risk of LDBF after July 25." Div.Br. 11-19. From the perspective of the charges against Mr. Hopkins, however, the most salient feature of this account is that it mentions him only once, and then only to say that *before* July 25 he had reported to his superiors that some clients were threatening to pull out of LDBF. Div.Br. 12. Thereafter, Mr. Hopkins disappears from the narrative: he is not mentioned again in the Division's description of the "course of conduct" that supposedly occurred after July 25. Div.Br. 12-19.

This account of the July 26 letter, giving Mr. Hopkins essentially no role in its creation, must be a reaction to the Initial Decision, in which the Law Judge gave the back of her adjudicatory hand to previous allegations that Mr. Hopkins bore legal responsibility for the letter. The Law Judge found that, in his minimal involvement with the preparation of the letter, Mr. Hopkins had been at most "a messenger. He did not decide on the message; rather, the July 26 letter delivered the Management Team's message. Hopkins was asked to comment on only one portion of one of many drafts; Hopkins did not review the final July 26 letter before it was sent." ID 51. The Law Judge also found that the July 26 letter was not materially misleading, ID 52, and that "there was no showing that Flannery or Hopkins acted with scienter or that they acted recklessly" in connection with the July 26 letter. ID 52, n.85.

The Division's current recitation makes no objection at all to the Law Judge's findings. The argument section of the Division's brief, meanwhile, takes only a vestigial swipe at Mr.

Hopkins with respect to the July 26 letter, spending exactly two sentences of its "scheme liability" argument on the assertion that he "was involved in drafting" the letter because "he suggested the core misleading language that SSgA had taken steps to 'reduce risk' in the fund, which went out in the final letter to investors." Div.Br. 35. Even if this passing mention qualifies as argument, it does not touch Mr. Hopkins, because there is once again a fatal temporal gap between theory and fact: Mr. Hopkins made his comment about risk reduction on July 24, Div. Ex. 125, when LDBF's investment team *was* in fact reducing its portfolio's risk in a variety of ways. Tr. 2865-66 (Wands). The AAA bond sale that, according to the Division, raised the Fund's risk profile, Div.Br. 13-14, did not occur until July 26, ID 16, and there is no evidence that Mr. Hopkins was aware of the sale beforehand.

IV. Materiality: The Division Failed To Carry Its Burden Of Proving That Mr. Hopkins Made Any Material Misrepresentations Or Omissions.

Materiality is an element of all the charges against Mr. Hopkins. Materiality is explicitly required by Section 17(a)(2) and Rule 10b-5(b), and a materiality requirement is implicit in Section 17(a)(1) and (3), and in Rule 10b-5(a) and (c), because materiality is the essence of any kind of "fraud," *Neder v. United States*, 527 U.S. 1, 22-23 (1999), and those provisions forbid either a "device, scheme or artifice to defraud," or a "transaction, practice or course of business which operates . . . as a fraud." *See* 15 U.S.C. §77q(a); 17 C.F.R.§240.10b-5; *see also* Div.Br. 33 (quoting *United States v. Rybicki*, 354 F.3d 124, 146 n.20 (2d Cir. 2003) ("the phrase 'scheme or artifice to defraud' requires 'material misrepresentations'")).

The Law Judge found that none of the alleged omissions attributed to Mr. Hopkins was material. ID 44-45 (fact sheets), 45-46 (typical slide), 49-50 (March letter), 52 (July 26 letter). The Division challenged this conclusion, at least in part, attacking the Law Judge's references to investor sophistication in portions of her materiality analysis and her underlying finding that

LDBF's institutional investors *were* highly sophisticated. Petition 6-8. The Division's brief in support of its Petition sketchily addresses the sophistication argument, *see* Section IV.A., below, but not before making another argument about materiality that its Petition had failed to mention.

A. The Alleged Omissions Were Immaterial Because They Occurred Before The Subprime Crisis Began.

The new argument is that the omitted information was "material in late 2006 and 2007, particularly because the misrepresentations concerned exposure to subprime RMBS during the subprime market crisis." Div.Br. 27. According to the Division, the materiality of information about the Fund's overall subprime exposure "is demonstrated by the fact that, once SSgA made the truth available to many of these institutional investors, they immediately decided to liquidate their holdings in LDBF and the Related Funds." Div.Br. 26.

The argument is essentially a non sequitur, and the evidence cited to "demonstrate" its validity does not do so. Even if the underlying premise is correct – even if the Fund's overall "exposure to subprime RMBS" would have been material "during the subprime market crisis" – Mr. Hopkins' alleged "omissions" all occurred *before* the subprime market crisis began in July 2007. [3/] As the Respondents' expert testified without contradiction, moreover, "the vast majority of market participants did not anticipate [the crisis] during the first six months of 2007." Sirri Report ¶76. Indeed, as the former Chairman of the Federal Reserve, Alan Greenspan, later testified, if the crisis had been anticipated, it would not have happened: "For the crisis to occur, it

[3/] The July 26 letter was sent to investors after the subprime crisis began, but the Division does not contend that Mr. Hopkins played any role in concealing the Fund's subprime exposure from investors in the letter, or at any time in July or August 2007. Mr. Hopkins spoke frequently to investors during this period, but the Division produced no evidence to suggest that he concealed the Fund's subprime exposure from any of them. To the contrary, the record shows that on July 25, when Hammerstein asked Mr. Hopkins and a colleague about the Fund's subprime position, he received an accurate answer. DFF ¶261. With respect to Mr. Hopkins' purported role in the preparation of the July 26 letter, meanwhile, the Division now notes only that he suggested an edit about State Street's efforts to reduce risk. Div.Br. 35.The edit was true when Mr. Hopkins suggested it, however, and he had no control over State Street's subsequent management of the Fund or over the decision to include a statement about risk reduction in the final draft of the letter. ID 50-51.

must be unanticipated by almost all market participants and regulators." Sirri Report ¶73. Thus, as Sirri's Report documented, during the first half of 2007 the approaching crisis was invisible to "even sophisticated market participants," to the ratings agencies, to the International Monetary Fund, to professional forecasters, and to the Federal Reserve Board. *Id at* ¶68,69,71,73.

The only way to say that Mr. Hopkins' "omissions" were material, then, is to ascribe importance that arose in July 2007 back into statements that were made in March or May. Given the unforeseen nature of the subprime crisis, however, time travel is forbidden. The securities laws do not countenance efforts to impose "fraud by hindsight," and this prohibition encompasses the element of materiality. "The determination of materiality is to be made upon all the facts at the time of the transaction and not upon a 20-20 hindsight view long after the event." *Spielman v. Gen. Host Corp.*, 402 F. Supp. 190, 194 (S.D.N.Y. 1975); *see also In re Union Carbide Class Action Sec. Litig.*, 648 F. Supp. 1322, 1327 (S.D.N.Y. 1986) (dismissing claim based on failure to disclose dangers posed by chemicals, when dangers became apparent only through subsequent accident: "[t]o permit these omissions to constitute a securities action would allow future plaintiffs to walk into court with a 'materiality through hindsight' cause of action").

For similar reasons, the Division does no better with its claim that materiality is "demonstrated by the fact that, once SSgA made the truth [about the Fund's subprime exposure] available to many of these institutional investors, they immediately decided to liquidate their holdings in LDBF and the Related Funds." Div.Br. 26. The evidence cited for this claim, however, reflected redemptions that took place in late July 2007, *see* DFF ¶¶278-88, 307-8, 420-26, and thus demonstrated that the investors' decisions to liquidate came in response to the subprime crisis itself, not to any "revelations" about the Fund's subprime exposure. If the Fund's exposure had been the material fact, then investors who knew the supposedly-material information *before* the crisis began would have "immediately decided to liquidate" as well. Other investors *did* know about the Fund's subprime exposure in the first half of 2007, yet none of them chose to redeem their investments until the second half of the year, after the crisis erupted. For example, in April 2007, Mr. Hopkins himself disclosed to a consultant, Cambridge Associates, that 75% of the Fund's assets were invested in subprime securities, yet none of Cambridge Associates' clients redeemed prior to July or August 2007. Div.Ex. 246, pp. 6-7; *see also* Div.Ex. 259, Hop.Ex. 64; Tr. 1999-2000 (Lowe); DFF ¶384.

What the evidence actually demonstrates, then, is that the Fund's subprime exposure was *not* "material information" before July 2007, when an unexpected liquidity crisis seized the market. State Street had previously "made the truth available" to a number of investors, yet as far as the record shows, those who knew about the Fund's subprime exposure behaved in exactly the same way as those who did not: they held their investments until the crisis came to a boil in the final days of July, and only then decided to sell their holdings. Division Post-Hearing Brief, 28 (internal investors "largely redeemed from LDBF on July 27 and August 2").

B. The Law Judge Properly Considered Investor Sophistication As An Element Of The Materiality Analysis.

The argument about investor sophistication is a tempest in a teapot, as suggested by the fact that the issue took up about one-third of the Division's Petition, *see* Petition 6-9, but only two paragraphs of its forty-three page brief. Div.Br. 29-30. The Law Judge merely noted that "LDBF's investors were sophisticated, institutional investors, most of whom engaged investment consultants to provide investment assistance," ID 40, and then mentioned this sophistication as a *factor* in her findings about the immateriality of the alleged omissions from the fact sheets, ID 45, typical slide, ID 46, and July 26 letter. ID 52. In each case, however, investor sophistication was only one factor of several: for example, in her discussion of the "typical slide," the Law

Judge commented that "no sophisticated investor would rely on this single piece of information," ID 46, but this was only one factor among at least six that she cited to support her conclusion about materiality. ID 46 (omission was not material because (1) the slide "on its face states that it is 'typical,'" (2) State Street provided information upon request about its actual LDBF portfolio, (3) such information was available from a variety of sources, (4) enhanced cash strategies were widely discussed in the press and well known in the financial community, (5) Hopkins brought current information about the portfolio's allocation to his presentations, and (6) most investors did not inquire into the composition of a fund's portfolio). The Initial Decision gives no indication that sophistication was an essential factor, and no indication that the Law Judge would have decided the matter differently if she excluded sophistication from the equation. Any error she might have made by referring to investor sophistication would have been harmless as a matter of law.

But there was no error. The Law Judge rightly considered investor sophistication as an element of the inquiry into materiality, and she correctly found that the Fund's investors were sophisticated actors. First, the Division erroneously claims that "the Initial Decision erroneously cited private actions holding that investor sophistication was relevant for reliance or scienter, not materiality." Div.Br. 30. In fact, the Law Judge, ID 40, cited a mix of cases which collectively demonstrated that investor sophistication may be relevant to the issues of reliance, *see, e.g., Myzel v. Fields*, 386 F.2d 718, 736 (8th Cir. 1967), scienter, *see, e.g., Martin v. Steubner*, 485 F. Supp. 88, 97 (S.D.Ohio 1979), *and* materiality. *Seibert v. Sperry Rand Corp.*, 586 F.2d 949, 951-52 (2d Cir. 1978).

This was the right approach. In the law of fraud, "materiality is intimately bound up with the concept of reliance." *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1260

(N.D.Cal. 2000). The alleged victim's sophistication may affect both reliance and materiality because "there is no duty to disclose information to one who reasonably should be aware of it." *Seibert*, 586 F.2d at 952 (quoting *Myzel*, 386 F.2d at 736). *Compare Scarfarotti v. Bache & Co.*, 438 F. Supp. 199, 206 (S.D.N.Y. 1977) (noting size of plaintiffs' investment portfolios when rejecting argument that omission was material to them), *with Berger v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 505 F. Supp. 192, 194 (S.D.N.Y. 1981) (distinguishing *Scarfarotti* and finding that materiality was a jury issue "where the broker may be shown to have had reason to believe that the investor was not financially sophisticated and would be unable to recognize the material facts themselves or deduce their implications from the information provided him").

This is why, in the area of securities fraud, several courts have ruled that investor sophistication is simultaneously relevant to both the extent of reliance *and* "the adequacy of the defendant's disclosure." *Drobbin v. Nicolet Instrument Corp.*, 631 F. Supp. 860, 891 (S.D.N.Y. 1986); *see also Quintel Corp. v. Citibank, N.A.*, 596 F. Supp. 797, 801-2 (S.D.N.Y. 1984). And it is why, in *SEC v. Happ*, 392 F.3d 12, 21-22 (1st Cir. 2004), the First Circuit properly cited a "reliance case" for its discussion of the relevance of investor sophistication to materiality. *Happ* was a civil enforcement action charging that the defendant had traded on material, nonpublic information. The First Circuit's determination of materiality took into account evidence that the respondent "was a financial expert." This evidence was relevant because a "sophisticated investor requires less information to call a 'misrepresentation into question' than would an unsophisticated investor" and because "when material information is omitted, a sophisticated investor is more likely to 'know enough so that the . . . omission still leaves him cognizant of the risk.'" *Id.* at 22 (quoting *Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1028-29 (4th Cir. 1997) (discussing relevance of sophistication to reliance)).

Second, there was ample support for the Law Judge's finding that LDBF's investors were sophisticated. The Fund was restricted to institutional investors, and as one court has noted, "[s]ome commentators argue that there should be a presumption of sophistication in cases involving institutional investors." *Banca Cremi v. Brown*, 955 F. Supp. 499, 512 (D.Md. 1997). The Fund's investors, moreover, were not just institutional investors, but typically "large institutions with hundreds of millions or even billions of dollars in AUM." Hop.Ex. 174 ("Peavy Report") ¶A.44. Among them were pension funds, university endowments, governmental authorities and hospitals. Sirri Report ¶21, n.9; Peavy Report ¶A.42. Several LDBF investors employed teams of investment professionals with high levels of investment expertise to manage their portfolios, while a substantial proportion of the remaining investors employed consultants (such as Yanni Partners) to advise them. Peavy Report ¶A.40. Indeed, the sophistication of the Fund's investor base was one reason it qualified for unregistered status. Unregistered funds gain their exemption precisely because they are limited to "sophisticated investors who are sufficiently capable of evaluating the risks, either on their own or by hiring consultants with the necessary expertise." Sirri Report ¶21; *see also* ID 40 (quoting *Goldstein v. SEC*, 451 F.3d 873, 875 (D.C.Cir. 2006) ("Investment vehicles that remain private and available only to highly sophisticated investors have historically been understood not to present the same dangers to public markets as more widely available investment companies, like mutual funds")).

V. <u>Culpability</u>: The Division Failed To Carry Its Burden Of Proving That Mr. Hopkins Acted With Scienter.

The charges against Mr. Hopkins also required the Division to prove that he acted culpably: with negligence, for purposes of the Section 17(a)(2) and (3) charges, and with scienter for purposes of the charges under Section 10(b) and Section 17(a)(1). *Aaron v. SEC*, 446 U.S. 680, 697 (1980). The Law Judge observed that her findings about falsehood and materiality "obviate[d] the need to address Hopkins' scienter or negligence," ID 45 (fact sheets), 46 ("typical slide"), 47 (client presentations), 50 (March letter), 52 (July 26 letter), but nevertheless she *did* find: (1) that with regard to the Fact Sheets, "there is no persuasive evidence that Hopkins conveyed information that he knew, or should have known, was materially false or misleading," ID 45; (2) that "[t]here is no persuasive evidence that Hopkins acted with scienter or negligence" in his conversation with David Hammerstein, ID 48, n.80; (3) that "there was no showing that Hopkins acted with scienter or that he acted recklessly" in preparing the March letter, ID 50, n.82; and (4) that "there was no showing that Flannery or Hopkins acted with scienter or that they acted recklessly" in connection with the preparation of the July 26 letter." ID 52, n.85.

The Division does not contend that Mr. Hopkins acted with conscious intent to defraud.[4/] Its theory of scienter against Mr. Hopkins, laid out in a scant paragraph, is that Mr. Hopkins "knew the information that was being misrepresented or concealed," and that he "was thus, at a minimum, extremely reckless in failing to correct these statements and omissions." Div.Br. 36. The Division's argument, in other words, is that Mr. Hopkins was "extremely reckless" in leaving the Fund's subprime exposure out of several communications because when he "made" the statements he "knew the information that was being . . . concealed" – that is, he knew the Fund's subprime exposure.

This misapprehends the scienter requirement. In order to be culpable as a matter of law, Mr. Hopkins had to know more than *what* the communications did not say. He had to have recklessly disregarded both (1) the fact that the "omitted" information caused the statements made to be misleading, and (2) the fact that the misleading omissions were material. *Geffen v.*

[4/] The Division also fails to make any argument that Mr. Hopkins was negligent. Section V.E. of its brief is *entitled* "Hopkins And Flannery Were Negligent In Violation of Section 17(a)(2) and (3)," but the ensuing argument talks only – and unconvincingly – about Mr. Flannery and never once mentions Mr. Hopkins. Div.Br. 39-40.

Micrion Corp., 249 F.3d 29, 35 (1st Cir. 2001) (scienter requires proof that defendants knew that statement was false or misleading, and that it was made in reference to a matter of material interest to investors).

The Division's argument thus conceals its failure to satisfy an essential aspect of its burden of proof. The Division could not, and did not, prove that Mr. Hopkins knew the allegedly misleading omissions were material, because the record made it clear that *nobody* at the time thought the omitted information was important. Tr. 2853, 2855-56 (Wands); Sirri Report ¶66; Tr. 2182-83 (Sirri). To repeat: in late 2006 and through the first half of 2007, *nobody* foresaw what Mr. Hopkins is supposed to have recklessly ignored: that a "subprime market crisis" was looming over the horizon. The investment community in general did not see it; the regulatory community did not see it; the media did not see it; Hammerstein and his colleagues at Yanni Partners did not see it; and neither did the investment professionals at State Street on whose expertise Mr. Hopkins relied. If the scienter requirement is to have any significance, then recklessness must mean more than "the defendant missed what everybody else missed, too."

VI. <u>Responsibility Under Rule 10b-5(b)</u>: Mr. Hopkins Is Not Liable Because He Did Not "Make" Any Of The Allegedly Actionable Documentary Misstatements Or Omissions.

At the hearing and in his post-hearing briefs, Mr. Hopkins argued that he could not be punished under Rule 10b-5(b) because the rule imposes liability only on persons who "make" a materially untrue statement or omission, and because Mr. Hopkins had not "made" any of the statements or omissions at issue in the manner required by the then-recent First Circuit decision in *SEC v. Tambone*, 597 F.3d 436, 446 (1st Cir. 2010). *See* Hopkins Post-Hearing Brief, 66-70; Hopkins Reply Brief, 36-38.

After the briefs were submitted, but before the Law Judge issued the Initial Decision, the Supreme Court decided *Janus*. The Court held that "[o]ne 'makes' a statement by stating it," and that "[f]or purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority or control over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not 'make' a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker." *Janus*, 131 S.Ct. at 2302.

The Law Judge was, of course, obligated to apply *Janus* to the charges here. Surveying the record, she found that Mr. Hopkins did not have the requisite "ultimate authority or control" over the alleged misstatements and omissions in (1) the fact sheets, ID 43-44, (2) the "typical" slide, ID 45, (3) the slides presented to investors at meetings in April and May 2007, ID 47, (4) the March 2007 letter, ID 49, or (5) the July 26 letter. ID 50.[5/]

The Division contends that Mr. Hopkins "made" the alleged misstatements in the "typical slide" and in another slide contained in the standard PowerPoint deck that was included in several presentations in the first half of 2007, including State Street's meeting with Hammerstein and his clients from National Jewish in May 2007. The Division argues that "the law is clear that Hopkins 'made' those misrepresentations" because the "PowerPoint presentations . . . were attributed to Hopkins by name on the front cover," and because "courts interpreting *Janus* have found that individuals are makers of any statements attributed to them by name. . . ." Div.Br. 21, 22.

This theory proves too much. Mr. Hopkins was not the only State Street employee whose name appears on the covers of the PowerPoint presentations in question. For example, Amanda

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5/ The Law Judge found, conversely, that Mr. Hopkins did have "ultimate authority" over the statements he made to Hammerstein during their phone conversation in April 2007 (but, of course, she also found that Mr. Hopkins had not made any material misstatements during that call). ID 48.

Williams is listed above Mr. Hopkins on the cover of the National Jewish presentation, and Chuck Martin and David Schiller are listed below him on the Catholic Healthcare presentation made two weeks earlier. Hop.Ex. 57, 135. Does this mean that Mr. Martin, Mr. Schiller and Ms. Williams, along with Mr. Hopkins, had "ultimate authority or control" over all of the statements made in all of the slides contained in each deck? Of course not. The person's name on the cover slide merely denoted him or her as one of the speakers at that presentation, and said nothing about his authorship of the following slides, which had been created and maintained as a "standard" set for use by State Street employees.

The presence of Mr. Hopkins' name on the cover slide of each deck, therefore, no more "attributed" the statements in the following slides to him than the presence of an actor's name on a theater program would "attribute" to him the statements made in a presentation of *Macbeth.* Whether this can fairly be called "attribution" at all, it clearly is not the sort of attribution that the Supreme Court was talking about in *Janus*, which focused on attribution only as a marker of whether the party to whom a statement has been attributed was "the person or entity with ultimate authority or control" over it. *Janus*, 131 S.Ct. at 2302. The kind of attribution that may serve this function is the kind that says, "These are X's words," and not something that merely suggests an *association* between X and the words.

The cases cited by the Division, Div.Br. 21, bear out this reading of *Janus*. A fact-finder may be able to infer that a respondent "made" a statement when a third party "attributes" it to him by reporting that he actually said it, *In re Merck & Co., Inc. Sec. Derivative & ERISA Litig.*, MDL No. 1658, 2011 WL 3444199, at *8, 25 (D.N.J. Aug. 8, 2011) (complaint alleged that defendant had "made" statement when newspaper article quoted him saying it), or where a document that contains an alleged misstatement directly attributes authority and control over the content of the statement to him. *Lopes v. Viera*, No. 1:06-cv-01243, 2012 WL 691665, at *6 (E.D.Cal. Mar. 2, 2012) (plaintiff could argue to jury that Viera "made" misleading statements in offering memorandum that "specifically attributes information to Defendant and specifically reports that the financial information provided in it . . . w[as] based upon information provided by Defendant").

The courts, however, have declined to erase the distinction between "attribution" that connotes actual authority or control and the sort of watered-down "attribution" that merely suggests an association between the defendant and the statements at issue. For example, in another case cited by the Division, *SEC v. Dafoitis*, No. C11-00137, 2011 WL 3295139 (N.D.Cal. Aug. 1, 2011), the complaint alleged that the respondent was liable for misstatements in two advertisements: one was an "[a]dvertisement quoting Dafoitis and containing his picture," while the other contained both his picture and allegedly-actionable statements, but did not purport to quote him. The trial court ruled that the complaint sufficiently alleged that Mr. Daifotis had "made" the statements in the advertisement that quoted him, but that the allegation about the second advertisement was "insufficient to state a claim under *Janus* – Dafoitis is not sufficiently alleged to have been the 'maker' of the statements in the advertisement solely based on an allegation that the advertisement included a picture of him." *Dafoitis*, 2011 WL 3295139, at *3.

Mr. Hopkins' name on a slide deck served the same, legally-insufficient function as Mr. Daifotis' picture on the second advertisement. It may have associated Mr. Hopkins with the statements in the document, but it did not attribute to him authority or control over the contents of those statements, and therefore did not indicate that he had "made" the allegedly-actionable statements within the meaning of Rule 10b-5(b), as interpreted by the Supreme Court.

VII. <u>Responsibility Under Section 17(a)(2)</u>: The Division Failed To Carry Its Burden Of Proving That Mr. Hopkins Obtained Money Or Property By Means Of The Alleged Misrepresentations And Omissions.

Section 17(a)(2) requires the Division to prove that Mr. Hopkins "obtain[ed] money or property by means of" an untrue statement or material omission. The Law Judge did not discuss this element in her Initial Decision, and the Division did not raise the issue in its Petition, but it is an essential element of the case against Mr. Hopkins and the Division's failure to prove that he obtained money or property by means of the alleged omissions and misrepresentations poses yet another insuperable obstacle to the Section 17(a)(2) charge.

Mr. Hopkins did not obtain any money or property for himself by means of his alleged misconduct. His compensation was not dependent on, or affected by, the attraction or retention of particular investors or by his participation in any of the events at issue. ID 8; Tr. 331-32 (Hopkins). He was not a salesman who earned commissions on sales made by means of alleged misstatements. *Cf. SEC v. Tambone*, 550 F.3d 106, 110, 112-13 (1st Cir. 2008) (reversing dismissal of Section 17(a)(2) claim where SEC alleged that "more than half of the total compensation that defendants received each year consisted of commission" from sales of mutual funds, and claim was that defendants had obtained money by means of omissions from fund prospectuses), *rehearing en banc granted, opinion withdrawn,* 573 F.3d 54 (1st Cir. 2009), *reinstated in relevant part,* 597 F.3d 436, 450 (1st Cir. 2010). He did not receive a bonus "explicitly tied" to his work on the transactions he had caused his employer to misrepresent. *Cf. In re CVS Caremark Corp.*, Rel. No. 8815, 2007 WL 1880048, at *5-6 (June 29, 2007). The Division did not prove that his alleged violations of the securities laws had such a substantial effect on State Street's bottom line that compensation tied to general corporate performance could have been affected by it. *Cf. SEC v. Hopper*, No. H-04-1054, 2006 WL 778640, at *12 (S.D. Tex. Mar. 24, 2006).

This case, rather, is much like *SEC v. Forman*, No. 07-11151-RWZ, 2010 WL 2367372 (D. Mass. June 9, 2010), in which the District Court granted summary judgment on a Section 17(a)(2) claim against the controller of a corporation who had allegedly drafted and filed misleading financial statements on the company's behalf. *Id.* at *4, 8. Although the SEC had evidence that all of the company's employees had received a 3% bonus, and that its executives had received a bonus "tied to [its] financial performance[,]" *id.* at *8, the claim was doomed by the lack of "evidence that the employee bonus was tied to company performance or that [the defendant] was an executive within the meaning of the bonus plan." *Id.*

The Division argues that this failure of proof is not fatal because *personal* aggrandizement is not required by the "obtain money or property" clause of Section 17(a)(2), and that Mr. Hopkins can be held personally and primarily liable because "Respondents obtained money for SSgA as a result of their misconduct." Div.Br. 22. This is a textually implausible proposition for which the Division has cited no competent authority.[6/] Even if it were correct, the Section 17(a)(2) claim is nevertheless doomed by the lack of evidence that Mr. Hopkins' alleged misconduct obtained any money or property for his employer. The argument thus ends where it began: with the fact that the Division did not call a single investor in the Fund to testify against either Respondent. As a consequence, there is no evidence in the record to suggest that a single investor made, increased, or maintained an investment in the Fund as a consequence of

[6/] The Division relies on *SEC v. Delphi Corp.*, No. 06-14891, 2008 WL 4539519, at *20 (E.D. Mich. Oct. 8, 2008), but *Delphi* is bad precedent. The trial court's decision contains no reasoned analysis of the "obtain money or property" clause, save for a bare citation to *SEC v. Youmans*, 543 F. Supp. 1292, 1299 (E.D. Tenn. 1982), *rev'd on other grounds*, 729 F.2d 413 (6th Cir. 1984). But *Youmans* itself says nothing at all about the "obtain money or property" requirement. It held that *scienter* need not be proved in a Section 17(a)(2) case, not that the "obtain money or property" requirement was impersonal. In *SEC v. Burns*, No. 84-0454, 1986 WL 36318, at *4 (S.D. Cal. Feb. 19, 1986), by way of contrast, the Court explicitly held that "[t]here is no evidence before this Court that Mr. Burns personally acquired money or property, hence the Court finds no violation of Section 17(a)(2)."

Mr. Hopkins' alleged violations of Section 17(a)(2), and no basis for an inference that either he *or* State Street "obtain[ed] money or property" thereby.

VIII. Responsibility Under Rule 10b-5(a) and (c) And Under Section 17(a)(1) and (3): The Division Failed To Carry Its Burden Of Proving That Mr. Hopkins Participated In A Scheme To Defraud Or A Course Of Business That Operated As A Fraud.

As an alternative ground of liability, the Division cites Rule 10b-5(a) and (c), and Section 17(a)(1) and (3), which prohibit participation in a "scheme to defraud" or a "course of conduct" that will "operate as a fraud" on investors. Div.Br. 30-34. To support the charges under these provisions, however, the Division makes only two specific claims: (1) that Mr. Hopkins' "conduct included failing to update fact sheets and PowerPoint presentations," and (2) that in connection with drafting the July 26 letter, Mr. Hopkins "suggested the core misleading language that SSgA had taken steps to "reduce risk" in the fund..." *Id.* at 34-45.[7/] In other words, according to the Division, the conduct giving rise to "scheme" liability was a subset of the conduct that supposedly justifies imposing "misrepresentation" liability under Section 17(a)(2) and Rule 10b-5(b).

This is impermissible. For reasons already stated, the Law Judge correctly ruled that Mr. Hopkins was not liable for his actions in connection with the fact sheets, PowerPoint presentations and July 26 letter because (1) the documents made no material misrepresentations or omissions, (2) Mr. Hopkins did not have the requisite scienter, and (3) Mr. Hopkins had not

[7/] In support of its "scheme liability" theory, the Division also made several non-specific assertions: (1) that "Hopkins and Flannery substantially participated in a series of misstatements and other deceptive actions that were part of a larger scheme to defraud investors in LDBF and the Related Funds," (2) that "Hopkins' misconduct lasted over a year, during which he routinely misrepresented to clients the nature of LDBF's subprime RMBS exposures and the way in which leverage increased the risk of those exposures," and (3) that "his conduct was repeated and was committed in derogation of his responsibility as a product engineer to ensure the flow of accurate and current information about LDBF...." Div.Br. 34-35. These hopelessly general allegations would not even suffice at the pleading stage, much less carry the Division's burden of proof at trial. *See SEC v. Lee,* 720 F. Supp. 2d 305, 334 (S.D.N.Y. 2010) (SEC must prove "what deceptive or manipulative acts were performed, which defendants performed them, when the acts were performed and what effect the scheme had on investors in the securities at issue.").

"made" the alleged misrepresentations. Absent any "materially false or misleading statements or omissions," the Law Judge concluded, "there can also be no fraudulent 'course of conduct' or 'scheme liability.'" ID at 57.

The "scheme liability" charges thus fall along with the "misrepresentation" charges, and for another reason as well: because the Division has never even claimed that Mr. Hopkins took part in a "scheme" that involved any conduct *apart* from the alleged misrepresentations. The principle has been stated and applied many times: "scheme liability under subsections (a) and (c) of Rule 10b-5 hinges on the performance of an inherently deceptive act that is *distinct* from an alleged misstatement." *SEC v. Kelly*, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011) (emphasis added).[8/] No distinct scheme or course of conduct was proven here: the only alleged fraud, and the only alleged cause of injury, were the Respondents' putative misstatements and omissions.

The Division has no good answer to this. It cites two Supreme Court cases for the proposition that a "scheme to defraud" may be "based solely on misleading statements or omissions," but the cited cases do *not* support the argument that scheme liability can be predicated on misstatements alone, in the "absence of additional or distinct deceptive conduct." Div.Br. 34. To the contrary, the defendants in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), were deemed liable (1) under Rule 10b-5(b) for those specific instances in which "the record reveals a misstatement of a material fact," *id.* at 152, and (2) under Rule 10b-5(a) and (c) for the larger scheme that the misstatements had facilitated – a scheme that involved the defendants as "market makers" who lined up buyers for the victims' securities, encouraged

8/ *See also WPP Luxemburg Gamma v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011); *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 177 (2d Cir. 2005); *SEC v. Brown*, 740 F. Supp. 2d 148, 171-172 (D.D.C. 2010); *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 475 (S.D.N.Y. 2005); *Swack v. Credit Suisse First Boston*, 383 F. Supp. 2d 223, 239 (D. Mass. 2004).

the victims to sell their shares at less than fair value, bought a number of shares themselves, and then resold the securities to the undisclosed buyers at a profit. *Id.* at 147-48, 153. Meanwhile, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158 (2008), the Court merely noted – without specifying whether the basis for liability might be Rule 10b-5(a), (b) or (c) – that liability under Section 10(b) and Rule 10b-5 in general can be predicated on deceptive "conduct" as distinct from oral or written statements.

IX. Sanctions

The Division has requested that the Commission impose: (a) a cease-and-desist order against Mr. Hopkins under Section 8A of the Securities Act and Section 21C(a) of the Exchange Act, Div.Br. 40-41; (b) a civil penalty under Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203(i) of the Advisors Act and Section 9(d) of the Investment Company Act, Div.Br. 41-42; and, (c) "appropriate remedial action" under Section 203(f) of the Advisors Act and Section 9(b) of the Investment Company Act. Div.Br. 42-43.

All of these requests must be denied because the Division has failed to prove that any of these sanctions are legally permissible and/or appropriate in this case. Needless to say, all of these sanctions require an actual violation of securities laws; as described throughout this brief, Mr. Hopkins did not violate any provision alleged in this OIP. However, even assuming *arguendo* some violation was found, no sanction is appropriate in this action.

A. Request for a Civil Penalty Should be Denied

1. The Division Cannot Apply Dodd-Frank Amendments

In seeking to impose civil penalties in this forum, the Division is trying to goad the Commission into impermissibly applying the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank") to conduct for which

Congress did not intend for it to apply. Dodd-Frank amended Section 8A of the Securities Act of 1933, Section 21B(a) of the Securities Exchange Act of 1934, Section 203(i) of the Investment Advisors Act and Section 9(d) of the Investment Company Act by permitting the Commission, for the first time in an administrative cease and desist proceeding, to obtain monetary penalties against a non-regulated person who violated provisions of those Acts. *See Gupta v. SEC*, 796 F. Supp. 2d 503, 507 (S.D.N.Y. 2011)("It appears undisputed that prior to the enactment of the Dodd-Frank Act...the SEC had *no* power to impose such penalties in an administrative action against a non-regulated person..."); *SEC v. Dafoitis*, No. C11-00137, 2011 WL 2183314, at *16-20 (N.D.Cal. June 06, 2011)(dismissing claims seeking to apply Dodd-Frank retroactively). Here, the Division is seeking a civil penalty against Mr. Hopkins under all of these provisions; in so doing, the Division is overstepping its authority *without even mentioning* the fact it is seeking the Commission to apply Dodd-Frank retroactively.[9/] In doing so, the Division is attempting to trick the Commission and violate Mr. Hopkins's constitutional rights.

Congress did not intend for Dodd-Frank to apply to conduct occurring before its enactment. Section 4 of Dodd-Frank states that "[e]xcept as otherwise specifically provided in this Act or the amendments made by this Act, this Act and such amendments *shall take effect 1 day after the date of enactment of this Act*." (emphasis added). Section 929P does not contain any specific prescription for retroactive application, therefore Dodd-Frank does not apply to conduct prior to its effective date. *See AT&T Corp. v. Hulteen*, 129 S. Ct. 1962, 1971 (2009); *Lockheed Corp. v. Spink*, 517 U.S. 882, 896 (1996). Moreover, assuming *arguendo* that there was no clear indication of Congressional intent, under *Landgraf*, absent Congress explicitly prescribing retroactive application, a court must determine "whether applying the statute to the person

[9/] Third tier penalties are inappropriate in this matter in any event because the Division has failed to show that Mr. Hopkins' actions "involved fraud and resulted in substantial losses to investors..." Div.Br. 42.

objecting would have a retroactive consequence in the disfavored sense of affecting substantive rights, liabilities or duties on the basis of conduct arising before its enactment. If the answer is yes, we then apply the presumption against retroactivity by construing the statute as inapplicable to the event or act in question owing to the absence of a clear indication from Congress that it intended such a result." *Fernandez-Vargas v. Gonzalez*, 548 U.S. 30, 37-38 (2006) (internal quotations omitted); *Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994); *Gupta*, 796 F. Supp. 2d at 507 ("...the OIP in effect seeks to apply Dodd-Frank retroactively, in seeming violation of the well-established rule that a statute will be presumed not to impose penalties retroactively unless it expressly so states."); *Dafoitis*, 2011 WL 2183314, at *16-20.

2. The Division Has Failed to Prove Mr. Hopkins' Association and Therefore Any Request for Civil Penalties Must Fail.

The Division acknowledged from the outset that it had to prove a connection between Mr. Hopkins and a registered investment advisor, namely State Street Global Advisors Fund Management ("SSgA FM"), "at the time of the alleged transaction" to sanction Mr. Hopkins under the Advisors Act or the Investment Company Act. 15 U.S.C. §80b-3(f); Division Prehearing Brief, 1, n.1 ("Respondents' associations with SSgA FM during the period of their alleged misconduct involving State Street's unregistered funds provides the basis for instituting this action pursuant to Section 203(f) of the Advisors Act and Section 9(b) of the Investment Company Act.").

For Hopkins to be deemed "associated" with an investment advisor, the Division must prove that he was a "partner, officer, or director of [an] investment advisor … any person directly or indirectly controlling or controlled by such investment advisor, including any employee of such investment advisor." 15 U.S.C. §80b-2(a)(17). *See, e.g, In re Maynard*, Rel. No. 2875, 2009 WL 1362796, at *1 (May 15, 2009); *SEC v. Bolla,* 401 F. Supp. 2d 43, 61, 62-

63, 65 (D. D.C. 2005); *In re Armstrong*, Rel. No. 2926, 2009 WL 2972498, at *3 (Sept. 17, 2009).[10/] The Division did not prove that Hopkins performed any of these functions; at most, the Division adduced passing commentary from Mr. Hopkins that he had some unspecified "responsibility" for some mutual funds during an unidentified time period. Tr. 20-21. In fact, the *only* mention of Mr. Hopkins's alleged association with SSgA FM, located on the last page of the Division's brief, merely states: "At the time [he] misrepresented facts concerning LDBF and the Related Funds, Hopkins ... [was] associated with SSgA FM, a registered investment advisor." Div.Br. 42. The Division fails to cite any facts in the record in support of its assertion of Mr. Hopkins' association at the relevant time period demonstrating their complete failure of proof. Div.Br. 42.[11/]

B. Request for Remedial Action and Cease-and-Desist Order Should be Denied

The Division cites two cases in support of their assertion that bars have been issued for violations similar to those alleged against Mr. Hopkins; however, both of these cases are ones in which the respondent's association with an investment advisor were undisputed and where there was either a criminal plea to the facts (*Reinhard*) or a jury finding of liability (*Seghers*), neither of which have occurred in this case. Div.Br. 42.

A cease and desist order would be equally unwarranted under the circumstances. Even taking them exactly as the Division portrays them, the violations alleged here were committed with no greater culpability than a failure to foresee that which the market in general failed to foresee. They caused no demonstrable harm, and occurred only sporadically for a short period of time, with Mr. Hopkins involved in no more than a handful of activities occurring over a period

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10/ Div.Ex. 254 is an attempt to demonstrate a link between SSgA and SSgA FM. Tellingly, the document specifically identifies SSgA employees with dual responsibilities. Div.Ex. 254; Tr. 1559. Mr. Hopkins is not identified as having any role at SSgA FM.

11/ Further, the Division is not entitled to relief under the Advisors Act or the Investment Company Act because it has not proven that Mr. Hopkins acted "willfully." 15 U.S.C. §80a-9(b)(2), 80(b)3(i)(1).

of several months. *See, e.g., WHX Corp. v. SEC*, 362 F.3d 854, 860 (D.C. Cir. 2004); *Steadman*, 603 F.2d at 1140 (5th Cir. 1979); Div.Br. 40-41.[12/]

Those events should, moreover, properly be measured against a much broader span of time – the decades that Mr. Hopkins has spent in the financial industry, during which his record is unblemished. As noted in the Initial Decision, every witness testified regarding Mr. Hopkins has a spotless reputation for integrity both on and off the job. ID 3, 8.

In considering whether to impose sanctions, finally, the Commission should consider both the nature of this action and the nature of Mr. Hopkins' role in the allegations. Mr. Hopkins did not cause the subprime crisis, and he did not benefit personally from the bubble that preceded it. He was merely a mid-level functionary in one of many financial institutions that failed to anticipate it. Plucking Mr. Hopkins out for punishment in order to "send a message," as the Division has put it, Div.Br. 40, would send a message alright: no good deed goes unpunished. Better to keep one's head down than volunteer to get the message out. Such a "message," of course, would not advance the remedial purpose of the federal securities laws one inch.

[12/] Further, the Division (again) misrepresented the facts adduced during this proceeding. Instead of proving that: "Investors in LDBF and the Related Funds lost hundreds of millions of dollars because of Respondents' conduct," *id.*, there was no evidence whatsoever that any investor lost any money due to the conduct of Mr. Hopkins. *See supra* Section III.

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' RULE 450(d)
CERTIFICATE OF COMPLIANCE

Pursuant to Commission Rule 450(d) I certify that Respondent *James D. Hopkins' Opposition to Division's Brief in Support of its Petition for Review* is 13,996 words exclusive of cover page, table of contents, table of authorities, and certificate of service using Microsoft Word 2007's word count function.

Respectfully Submitted,

By his attorneys,

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Dated: May 30, 2012

CERTIFICATE OF SERVICE

I hereby certify that on May 30, 2012 true copies of *Respondent James D. Hopkins' Rule 450(d) Certificate of Compliance* were served as follows:

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