05-0115-CV

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

AT HOME CORPORATION,
Plaintiff - Appellant,

v.

COX COMMUNICATIONS, INC., COX@HOME, INC., COMCAST CORPORATION, COMCAST ONLINE COMMUNICATIONS, INC., COMCAST PC INVESTMENTS, INC., BRIAN L. ROBERTS and DAVID M. WOODROW,
Defendants - Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, SUBMITTED AT THE REQUEST OF THE COURT

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INTRODUCTION

The Securities and Exchange Commission submits this brief as *amicus curiae* in response to a request by the Court.

This action was brought by At Home Corporation ("At Home," "issuer," or "plaintiff") under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), to recover alleged short-swing profits obtained by insiders of At Home. The complaint alleges that defendants - - Cox Communications, Inc., Comcast

Corporation and their affiliates - - sold and then purchased, or purchased and sold, At Home equity securities within six months. The defendants are alleged to have acted as a group that owned more than 10 percent of At Home securities, and thus to be statutory insiders of At Home. The suit seeks recovery of profits the defendants allegedly realized on these short-swing trades. The district court dismissed plaintiff's Section 16(b) claims. *See At Home Corporation v. Cox Communications, et al.*, 340 F. Supp. 2d 404 (S.D.N.Y. 2004). The Commission agrees with the district court that defendants are not liable under Section 16(b).

BACKGROUND

At Home was founded by a number of cable companies in March 1995 to provide cable-based internet access to customers (Compl. ¶18). On March 28, 2000, the defendants, Cox and Comcast, entered into a letter agreement with AT&T ("agreement") in which Cox and Comcast acquired, respectively, a put to sell to AT&T up to $1.4 billion and $1.5 billion in At Home shares. Under the terms of the agreement, Cox and Comcast could sell each share for the higher of (1) $48 or (2) a floating average market price at the time of exercise (A-133; Compl. ¶45).

Defendants notified AT&T of their intention to exercise their puts on January 11, 2001. At that time, At Home's shares were selling for an average $7.72 per share (Compl. ¶53). Accordingly, defendants' notices to AT&T stated that the defendants "assumed" that the purchase price would be $48 per share (A-165, 168). AT&T did

not want the shares. AT&T and the defendants entered into a new agreement on May 18, 2001 whereby the defendants canceled their puts in exchange for 155.3 million shares of AT&T stock worth $3.43 billion (Compl. ¶56).

The plaintiff alleged that Cox and Comcast sold At Home shares for purposes of Section 16(b) on January 11, 2001, when they provided notice of their intent to exercise the puts.1/ This was within six months of the May 18, 2001 agreement to rescind the puts, which plaintiff contended was a purchase of At Home securities. The district court agreed that the rescission was a purchase, but held that the earlier sale occurred on March 28, 2000, when the puts were established, so that the sale and purchase took place more than six months apart, and were thus not subject to Section 16(b).

The plaintiff alternatively claimed that if the sale occurred on March 28, 2000, Comcast made matching purchases when, between January and August 2000, it acquired three cable companies that held At Home securities. The district court dismissed this claim, holding that these indirect acquisitions were not cognizable transactions under Section 16(b).

1/ Alternatively, the plaintiffs contended that the sales occurred on February 2, 2001, at the end of the 30 day period for determining if the fixed rate or the floating rate was higher.

The plaintiff appealed, and this Court has sent a letter to the Commission inviting it to answer five questions. We address those questions in order.

ARGUMENT

I. THE ESTABLISHMENT OF THE PUTS IN MARCH 2000 CONSTITUTED A SALE OF AT HOME STOCK FOR PURPOSES OF SECTION 16(b).

The Court asks "[w]hether the establishment of the puts on March 28, 2000 constituted a sale of At Home securities for purposes of section 16(b) * * *." It did. Before 1991, the purchase or sale of securities underlying a derivative security occurred on the exercise of the derivative, rather than upon its creation. In 1991, the Commission noted that this left "open a significant potential for short-swing abuse in trading derivative securities." *Ownership Reports and Trading By Officers, Directors and Principal Securities Holders*, Exchange Act Rel. No. 28869, 56 Fed. Reg. 7242, 7250 (Feb. 21, 1991). In that release, the Commission offered the following example:

> [A]n insider with knowledge of a positive material development, to be announced shortly, determines that while he wants to retain his existing equity position, he wants to take advantage of the information, so he purchases issuer warrants. After the public announcement and rise in the stock price the insider sells his common stock, obtaining a short-swing profit, knowing that he can replace the shares at a predetermined price since he holds the warrants. Under the former rules, he could simply wait six months and a day to exercise the warrants so the profit would not be subject to section 16(b) and not recoverable by the company.

Id. at 7250. Likewise, an insider who knows of impending negative information can negotiate a fixed price put, enabling it to sell, after the negative information is released and the price falls, at the higher price. The insider unfairly uses the inside information by fixing the price when the derivative is created, not when it is exercised.

In 1991, the Commission amended the rules so that the acquisition of a "derivative security" is also considered the acquisition of the underlying securities for purposes of Section 16(b). "[D]erivative security" was defined to mean "any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an equity security * * *." Rule 16a-1(c), 17 C.F.R. 240.16a-1(c). Rule 16b-6(a), 17 C.F.R. 240.16b-6(a), provides:

> The * * * establishment of or increase in a put equivalent position or liquidation of or decrease in a call equivalent position shall be deemed a sale of the underlying securities for purposes of section 16(b) of the Act * * * .

A "put equivalent position" is defined by Rule 16a-1(h), 17 C.F.R. 240.16a-1(h), to mean "a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option position." A put with a fixed exercise price increases in value as the

price of the underlying stock decreases because the spread between the market price and the fixed exercise price increases.

On the other hand, a floating price linked to the market price does not have that attribute. The 1991 rules draw a sharp distinction between fixed and floating prices. The Commission explained that "[r]ights without a fixed exercise price do not provide an insider the same kind of opportunity for short-swing profit since the purchase price is not known in advance." *Ownership Reports*, Exchange Act Rel. No. 28869, 56 Fed. Reg. at 7252. The Commission stressed that "[t]he opportunity to lock in a profit begins when the exercise price is fixed; at that time, the right becomes a derivative security subject to section 16." *Id.* Conversely, the later *exercise* of a derivative at its *previously* fixed price is exempt from Section 16(b) and has no Section 16(b) consequences. *See* Rule 16b-6(b), 17 C.F.R. 240.16b-6(b).

On the other hand, the Commission explained that:

> [A] right with a floating exercise price is not required to be reported and will not be deemed to be acquired or purchased, for section 16 purposes, until the purchase price of the underlying security becomes fixed or established, which commonly occurs at exercise. Thus, a right to purchase an equity security is deemed acquired as of the date the exercise or conversion price becomes fixed, and the acquisition, absent an exemption, would be matchable for section 16(b) purposes with a disposition within six months of the fixing of the price.

56 Fed. Reg. at 7253. "The primary potential for abuse [of inside information] arises at the time of exercise for a floating price derivative security because only at exercise

is the price fixed and, therefore, the extent of the profit opportunity defined." Thus, "[b]y treating the exercise of the floating price derivative security as the 'acquisition' of the underlying security, the rules mitigate the incentives for insiders to abuse their informational advantage." 2/

In this case, the March 2000 agreement presented the defendants with puts with a fixed price of $48 paired with puts with a floating price based on a specified market average. In January 2001, with the market price far below $48, the defendants chose to exercise their puts at the fixed price. The opportunity to abuse inside information existed only at the time the fixed exercise price was set. If inside information is learned only after the fixed price is set, the information cannot be abused in later exercising at the fixed price. Because the fixed price was used in this case, the establishment of the puts is when the six month trading period should begin. The district court correctly concluded that the establishment of the puts in March 2000 constituted a sale of At Home stock under Section 16(b).

Plaintiff nevertheless argues that the hybrid security should be treated as a floating price derivative security, as though there were no fixed component. The cornerstone of plaintiff's contention is that, "in contrast to any other instrument in

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2/ This is reflected in Rule 16a-1(c)(6), 17 C.F.R. 240. 16a-1(c)(6), which excludes from the definition of a "derivative security" "[r]ights with an exercise or conversion privilege at a price that is not fixed."

any other reported case of which we are aware, the only fixed component at issuance was not the number of shares or price per share, but the total consideration to be paid by the grantor of the option (AT&T)." (Appellant's Brief p. 37 (emphases in original)). Thus, "[t]he only fact that all the parties to the Put knew on March 28, 2000 was that AT&T would pay a total of approximately $2.9 billion, but the number of shares and the price per share could not be known until after notice was given and the stock market determined the final price"(Appellant's Brief p. 37-38).

The district court correctly rejected this argument, pointing out that "[t]he specified maximum overall price of $2.9 million, when combined with the specified minimum per- share price of $48, dictated that defendants could sell, at most, 60.4 million shares.3/ Thus the initial agreement *did* limit the number of shares which AT&T would be required to buy." 340 F. Supp. 2d at 410 (emphasis in original).4/

3/ Since both the total and per share prices were fixed, the number of shares with respect to the fixed price component was fixed.

4/ Plaintiff also argues that the holding of the district court is unworkable in cases when the insider exercises a hybrid put at the floating rate because it would require there to be a second sale of the same underlying securities: "There could not be a 'second' sale, because according to the district court, all of the shares were deemed sold on March 28, 2000 at $48 per share * * * " (Appellant's Brief p. 37). This is incorrect. Where an insider exercises a hybrid put at the floating price, the fixed price put expires on an exempt basis by virtue of Rule 16b-6(d). The underlying shares become available for a different sale.

II. THE MAY 2001 AGREEMENT TO CANCEL THE FIXED PRICE PUTS WAS A PURCHASE FOR SECTION 16(b) PURPOSES.

The Court next asks whether the May 18, 2001 agreement – in which the defendants agreed not to exercise their puts – was a purchase for purposes of Section 16(b). The district court held that it was a purchase but that, since it occurred more than six months after the sale on March 28, 2000, the plaintiff's first claim should be dismissed. That is correct.

Under Rule 16b-6(a) the "liquidation of or decrease in a put equivalent position shall be deemed a purchase of the underlying security for purposes of section 16(b) * * *." The May 2001 agreement explicitly cancelled what had been the defendants' put equivalent position. Rule 16b-6(d), 17 C.F.R. 240.16b-6(d), provides that "[t]he disposition or closing of a long derivative security position, as a result of cancellation or expiration, shall be exempt from section 16(b) of the Act *where no value is received* from the cancellation or expiration" (emphasis added). This agreement does not qualify for that exemption since Cox and Comcast did receive value in exchange for agreeing to forgo the right to exercise their puts.

Defendants nonetheless contend that "[a]fter the March 2000 Put was exercised on January 11, 2002, *there was no put to 'cancel'*" and that the "[c]ourts uniformly have held that 'once an option is exercised, *the option itself ceases to exist* and an enforceable bilateral contract is formed.'" (Brief of Appellee Cox p. 45 (emphases

in original); *see also* Brief of Appellee Comcast pp. 38-39). Defendants' argument places semantics over substance: while the defendants gave notice of their intent to exercise the puts, they never, in fact, followed through and transferred any shares to AT&T.

III. COMCAST'S ACQUISITION OF THREE CABLE COMPANIES THAT OWNED AT HOME WARRANTS WAS NOT A PURCHASE OF THE WARRANTS FOR PURPOSES OF SECTION 16(b).

This Court's third question is "[w]hether Comcast's acquisition of three cable companies that owned warrants to purchase shares of At Home stock in January, March and August 2000 should be characterized as a § 16(b) purchase of At Home securities." Under Count II of their complaint, plaintiff urges that if, *arguendo*, as Comcast contends, the creation of the put in March 28, 2000 constituted a 'sale' for purposes of Section 16(b), then that sale can be matched with Comcast's acquisition of the warrants, which took place within six months of March 28, 2000 (Appellant's Brief pp. 44-46; *See also* Compl. ¶ 74).5/ The plaintiff argues that "purchase," as defined by Section 3(a)(13) of the Exchange Act, 15 U.S.C. 78c(a)(13), includes "any contract to buy, purchase, or otherwise acquire" and that this definition is broad enough to include the purchase of another company that, in turn, owns securities of the issuer (Appellant's Brief pp. 44-46).

5/ There are no allegations against Cox in Count II.

The district court held that these transactions are not within the scope of Section 16(b) because the acquisition of the warrants was an incidental part of acquisitions of the three companies. Without deciding whether this amounted to a "purchase" of securities for purposes of Section 16(b), the court held (340 F. Supp. 2d at 411):

> 'In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent--the realization of short-swing profits based upon access to inside information.' *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594 [ ] (1973). We can conceive of situations where an insider could acquire one company simply (or mainly) to obtain its interests in the subject company, as when the acquired company has few other assets or exists for the sole purpose of trading in shares of the subject company. However, plaintiff has failed to plead any facts giving rise to such a possibility here.

The district court was correct to find that this sort of indirect acquisition in a change-in-control transaction typically does not fall within the scope of Section 16(b). The district court, however, incorrectly resolved the issue by use of *Kern*. The *Kern* Court held that a transaction that literally falls within the scope of Section 16(b) may, nevertheless, be excluded from the section if, on the facts of the case, it does not present a risk of speculative abuse. While the defendant in *Kern* was a greater than 10% owner of stock in the issuer, it also was an unsuccessful hostile tender offeror. To the Court, the critical factors in excluding the defendant from liability under

Section 16(b) were that the defendant was forced to sell pursuant to a merger agreement, whose terms it did not negotiate, and, as a hostile tender offeror, the defendant did not have access to inside information. *See Kern*, 411 U.S. at 597-98. This Court has read *Kern* to require that the insider not have access to inside information and/or have no control over the terms of the transaction or its occurrence. *See American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1054 (2d Cir. 1974). Here, defendant Comcast does not meet either of those criteria, and we believe *Kern* does not apply.

This case calls for a different approach. The acquisition of At Home warrants here was an indirect consequence of a change-in-control transaction. In general (although there can be exceptions, as we discuss below), this sort of indirect and incidental acquisition should be presumed not to be a "purchase" for purposes of Section 16(b), since it is not the sort of transaction Congress was concerned about. The Supreme Court has stated that "'the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great.'" *Kern*, 411 U.S. at 592 (*quoting Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 422 (1972)). As the Commission explained long ago, a six-month period was chosen because that "arbitrary period" was thought "as roughly marking the distinction

between short swing speculation and long term investment." *Notice of Proposal to Adopt a Rule Exempting from the Operation of Section 16(b) Certain Acquisitions and Dispositions of Securities Pursuant to Mergers or Consolidations*, Exchange Act Rel. No. 4696, 17 Fed. Reg. 3177, 1952 SEC LEXIS 63 (April 9, 1952).

Because Section 16(b) can be harsh in imposing strict liability, "Congress itself limited carefully the liability imposed by §16(b)." *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 252 (1976). 6/ "When Congress has so recognized the need to limit carefully the 'arbitrary and sweeping coverage' of §16(b) * * * courts should not be quick to determine that * * * Congress intended the section to cover a particular transaction." *Id*. at 252 (citations omitted). *See also Gollust v. Mendell*, 501 U.S. 115, 122 (1991); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934).

An insider who seeks to profit from inside information typically will engage in a purchase or sale in the issuer's securities, and then engage in an opposite-way transaction when the information becomes public, and the securities' price is affected. A change in control, however, is typically motivated by a desire to acquire control of a company. It also involves complex negotiations, and many strategic corporate considerations, and often involves regulatory review and approval. While it is not beyond possibility that an acquiror would tailor a change in control transaction to

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6/ *See also Gollust v. Mendell*, 501 U.S. 115, 122 (1991); *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. at 422-25.

obtain short-swing profits from insider trading, it is certainly not going to be a common scenario. Good faith change in control transactions are not ones "in which the possibility of abuse [is] intolerably great," *Kern*, 411 U.S. at 592.

The plaintiff nonetheless argues that these acquisitions literally meet the words of the definition of "purchase" in Section 3(a)(13) of the Exchange Act. However, the prefatory language to the Exchange Act definitions states that they apply "[w]hen used in this title, unless the *context otherwise requires*." Section 3(a), 15 U.S.C. 78c(a) (emphasis added). This Court has "recognized the importance of this introductory phrase in certain situations." *Yoder v. Orthomolecular Nutrition Institute, Inc.*, 751 F.2d 555, 559 (2d. Cir. 1985). For example, Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10), excludes from the definition of "security" "any note * * * which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." In spite of this language, which would seem to exempt all notes of any quality, so long as of proper duration, this Court has long held, citing the context clause, that the exemption does not apply "literally," but only applies to notes that are the equivalent of commercial paper. *See, e.g., SEC v. American Board of Trade, Inc.*, 751 F.2d 529, 538 (2d Cir. 1984)(Friendly, J.).

Employment of the context clause is likewise appropriate here. As discussed above, Section 16(b) is a strict liability statute. The purpose of the provision must be taken into account when construing the Section 3(a) definitions of "purchase" and "sale" with respect to Section 16(b). Since a change in control transaction will rarely be used to engage in insider trading in securities held as an asset by the acquired company, this sort of indirect acquisition should presumptively be deemed not to be a purchase for purposes of Section 16(b) (or a sale by the prior owners of the company). We say "presumptively" because, as the district court noted, there may be circumstances where an insider uses the acquisition of another entity as a subterfuge in order to acquire underlying securities. The plaintiff, however, should bear the burden of pleading and proving that this indirect acquisition was such an exception, something the plaintiff has not done here. 7/

IV. THE "UNORTHODOX TRANSACTION DOCTRINE" IS INAPPLICABLE TO THE TRANSACTIONS IN THIS CASE.

This Court next asks "[w]hether the *Kern* 'unorthodox transaction' doctrine supports the District Court's dismissal of either of the relevant claims." As discussed in the prior section, we do not believe that the doctrine should be expanded to apply,

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7/ This does not mean, as might be thought, that Section 16(b) would cease to be a strict liability statute. It is a strict liability statute with respect to short-term transactions that are properly deemed purchases and sales for purposes of the statute. The inquiry here is whether a purchase was involved.

as the district court did, to the claim based on indirect acquisition of At Home warrants in three change of control transactions.

Separately, Cox argues that dismissal of plaintiff's *first* cause of action should be affirmed because "[a]s in *Kern County*, AT&T 'undoubtedly knew more about' At Home than Cox at the time of the alleged 'purchase' and 'sale'" (Brief of Appellee Cox pp. 54-55, *citing Kern County*, 411 U.S. at 602). While this might be true, it is not a basis for applying *Kern*, which this Court has read to require lack of access to inside information and/or a forced transaction, neither of which existed here.

V. CONTROLLING DEFERENCE IS OWED BY THE COURT TO THE COMMISSION'S REASONABLE INTERPRETATIONS OF SECTION 16(b) AND RELATED COMMISSION RULES.

The Court asks "[w]hat deference, if any, this Court owes the positions the SEC adopts in its *amicus curiae* brief." This actually presents two questions: (1) what deference is owed to the Commission's construction of its own rules in an *amicus* brief; and (2) what deference is owed to the Commission's construction of the federal securities statutes provided in an *amicus* brief.

A. This Court and the Supreme Court Have Repeatedly Held that a Court Is Bound by an Agency's Reasonable Interpretations of Its Own Regulations Provided in an *Amicus* Brief.

The deference accorded by the courts to the Commission's interpretations of its own rules in an *amicus* brief is settled law. This Court has repeatedly held that it is "'bound by the SEC's interpretations of its regulations in its *amicus* brief, unless they

are 'plainly erroneous or inconsistent with the regulation[s].'" *DeMaria v. Andersen*, 318 F.3d 170, 175 (2d Cir. 2003) and *Levy v Southbrook International Investments, Ltd.*, 263 F.3d 10, 14 (2d Cir. 2001) (*both cases quoting Press v. Quick & Reilly, Inc.*, 218 F.3d 121, 128 (2d Cir. 2000)). *Accord Yourman v. Giuliani*, 229 F.3d 124, 128 (2d Cir. 2000) (deferring to an interpretation of regulations submitted in an *amicus* brief by the Secretary of Labor). In *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945), the Supreme Court first established the principle that an agency's interpretation of one of its own regulations commands substantial judicial deference such that the agency's interpretation "becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation."

More recently, the principle was reinforced in *Auer v. Robbins*, 519 U.S. 452 (1997), where petitioner complained that an agency's interpretation of a regulation came in the form of an *amicus* brief. The Supreme Court declared, "[t]hat does not, in the circumstances of this case, make it any less worthy of deference" because the agency's "position is in no sense a '*post hoc* rationalizatio[n]' advanced by [the] agency seeking to defend past agency action against attack" 519 U.S. at 462 (*quoting Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 212 (1988)). "There is simply no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment on the matter in question." *Id.* *See also Barnhart v. Walton*, 535 U.S. 212, 217 (2002) (reaffirming *Auer*). As this Court has explained:

> [W]e recognized that an agency's interpretation of its own regulations is entitled to considerable deference, irrespective of the formality of the procedures used in formulating the interpretations. *See Taylor v. Vt. Dep. of Educ.*, 313 F.3d 768, 779-80 (2d Cir. 2002) (*citing Auer v. Robbins* [,*supra*,at 461]); *LaFleur v. Whitman*, 300 F.3d 256, 277 (2d Cir. 2002)). We defer to an agency's interpretation of its own regulations because we 'presume that the power authoritatively to interpret [the agency's] own regulations is a component of the agency's delegated lawmaking powers.' *Martin v. Occupational Safety & Health Rev. Com'n.*, 499 U.S. 144, 151 [] (1991).

Ecarnacion v. Barnhart, 331 F.3d 78, 86 (2d Cir. 2003).8/ In light of the well established law in the Supreme Court and this Court, the Commission's interpretations of its rules expressed in this brief are binding, unless they are plainly erroneous or inconsistent with the regulations.

B. This Court Should Accord *Chevron* Deference to Interpretations of the Federal Securities Statutes Provided in Commission *Amicus* Briefs.

The Court also owes controlling deference to the Commission's interpretation of the statute – Section 16(b) – provided in this *amicus* brief. The analysis of this question begins with *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). As the Supreme Court has recently summarized:

8/ There are three preconditions for applying *Bowles* or *Auer* deference: the language of the regulation in question must be ambiguous; there must be no reason to suspect that the interpretation does not reflect the agency's fair and considered judgment on the matter in question; and the agency's reading of its regulation must be fairly supported by the text of the regulation itself. *Drake v. FAA*, 291 F.3d 59, 68 (D.C. Cir. 2002) (citations omitted).

> In *Chevron*, this Court held that ambiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion. Filling these gaps, the Court explained, involves difficult policy choices that agencies are better equipped to make than courts. 467 U.S., at 865-866, 81 L. Ed. 2d 694, 104 S. Ct. 2778. If a statute is ambiguous, and if the implementing agency's construction is reasonable, *Chevron* requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation. *Id.* at 843-844, and n. 11, 104 S. Ct. 2778.

National Cable & Telecommunications Assoc., v. Brand X Internet Services, __ U.S. __, 125 S.Ct. 2688, 2699 (2005). 9/

For an agency interpretation to receive *Chevron* deference, the agency must have been entrusted by Congress with authority to interpret the statute, the statute must be ambiguous and subject to interpretation, and the agency's interpretation must be a reasonable one. The term "purchase" as applied to Section 16(b) is ambiguous. Congress has entrusted the Commission with responsibility for resolving ambiguities in light of the purpose of the statute. Section 16(b) provides that "[t]his subsection shall not be construed to cover * * * any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within

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9/ Prior to *Chevron*, the Court held in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), that the "rulings, interpretations and opinions of" an agency that do not constitute an exercise of lawmaking authority, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment" which are "entitled to respect" to the extent they are persuasive. *Id.* at 140.

the purpose of this subsection." As this shows, Congress did not believe Section 16(b) was self-explanatory and vested the Commission with authority to identify the purpose of the statute and identify transactions which do not contravene the section's purpose. 10/

The Commission has generally done that through rulemaking. However, rulemaking is not a prerequisite for the Commission's views to be accorded *Chevron* deference. While earlier cases focused on the formality of an agency decision, such as whether it was the product of notice and comment rulemaking or of an adjudication, *see Christensen v. Harris County*, 529 U.S. 576, 587 (2000), more recent cases have focused on whether the interpretation is the product of authoritative agency consideration. In *United States v. Mead Corp.*, 533 U.S. 218 (2001), the Court addressed the level of deference to be accorded to Customs Service tariff classifications contained in "letter rulings." The court held that "administrative implementation of a

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10/ In two recent cases, this Court declined to give *Chevron* deference to Commission *amicus* briefs because the statutes at issue did not explicitly look to the Commission to fill in interstices in the statutes. *See Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 34 n.6 (2d Cir.), *cert. granted*., 126 S. Ct. 34 (2005) (Mem.) (construing provision of Securities Litigation Uniform Standards Act preempting state law securities fraud actions); *In re Enterprise Mortgage Acceptance Co., LLC, Securities Litigation*, 391 F.3d 401, 410 n.8 (2d Cir. 2005) (construing provision in Sarbanes-Oxley Act modifying statutes of limitation in private securities lawsuits). Whatever the merit of those decisions as to those statutes, this case involves a statute, Section 16(b), in which Congress expressly delegated to the Commission that responsibility.

particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Id.* at 226-27. While the Court noted that "the overwhelming number of our cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication," the Court added:

> That said, and as significant as notice-and-comment is in pointing to *Chevron* authority, the want of that procedure here does not decide the case, for we have sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded.

Id. at 230-31. The Court held that "[t]he fact that the tariff classification here was not a product of such formal process does not alone, therefore, bar the application of *Chevron*," *Id.* at 231. The opinion, however, gives little conclusive guidance as to what must be shown, since the Court held that the authorities cited to it - - letter rulings issued by 46 different scattered Customs offices - - were obviously not authoritative agency positions. *See id.* 233.

The next year, however, in *Barnhart v. Walton*, 535 U.S. 212 (2002), the Court achieved some clarity by stating flatly that an agency interpretation may be entitled to *Chevron* deference even when it is neither the product of notice-and-comment rulemaking nor has the force of law. The major factor the Court looked to is the level of *careful consideration an agency has given the question*. *See* 535 U.S. at 222. In

Barnhart the petitioner, whose application for benefits was denied by the Social Security Administration, asked the Court to disregard the agency's interpretation found in recently promulgated regulations. The Court noted that the interpretation in fact was a "long standing" one and "the fact the Agency previously reached its interpretation through means less formal than 'notice and comment' rulemaking * * * does not automatically deprive that interpretation of the judicial deference otherwise due" under *Chevron*. 535 U.S. at 221 (citations omitted). Then, turning its attention to the confusion caused by *Christensen* and *Mead*, the Court stated:

> If this Court's opinion in *Christensen* * * * suggested an absolute rule to the contrary, our later opinion in *United States v. Mead* * * * denied the suggestion. * * * Indeed, *Mead* pointed to instances in which the Court has applied *Chevron* deference to agency interpretations that did not emerge out of notice-and-comment rulemaking. * * * It indicated that whether a court should give such deference depends in significant part upon the interpretative method used and the nature of the question at issue.

535 U.S. at 221-222 (citations omitted).11/ The Court went on to conclude (*id.* at 222):

11/ As this makes clear, not every informal statement of agency position is to be accorded *Chevron* deference. The Supreme Court has since declined to accord such deference to internal agency guidance, such as that "presented in internal guidance memoranda," *Alaska Dept. of Environmental Conservation v. EPA*, 540 U.S. 461, 487 (2004), and an internal operating manual, *Washington State Dept. of Social and Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 385 (2003). We believe that the public position articulated here by the Commission itself, with the deliberative process undertaken to reach its position and the explanation of the reasons for that position, is more akin to the sort of articulations contained in rulemaking than it is to internal guidelines.

> In this case the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time all indicate that *Chevron* provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue. * * *
>
> Later that year, this Court construed *Barnhart* to mean:
>
> Less formal interpretations may also be entitled to mandatory deference, depending upon to what extent the underlying statute suffers from exposed gaps in its policies, especially if the statute itself is very complex, as well as on the agency's expertise in making such policy decisions, the importance of the agency's decisions to the administration of the statute, and the degree of consideration the agency has given the relevant issues over time. *See Barnhart v. Walton*, 535 U.S. 212, 122 S. Ct. 1265, 1272, 152 L. Ed. 2d 330 (2002).

Community Health Center v. Wilson-Coker, 311 F.3d 132, 138 (2d Cir. 2002).12/

The only statutory interpretation in this brief is whether Section 16(b) applies to a transaction where an insider acquires securities of an issuer indirectly by acquiring ownership of a third party company which, in turn, owns securities of the issuer. This is precisely the sort of question that Congress directed the Commission to deal with. Section 16(b) states that it will not apply to transactions which the

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12/ In *Dabit* and *Enterprise Mortgage*, this Court later cited *Mead* for the proposition that Commission views expressed in an *amicus* brief, rather than a rule or regulation, cannot receive *Chevron* deference. That position appears contrary to the Supreme Court's decision in *Barnhart* and this Court's decision in *Community Health Center*.

Commission exempts as not within the purpose of the statute. Because the statute imposes strict liability, the Commission's role in determining when to exempt transactions is of critical importance to application of the statute. Congress and the Supreme Court have been clear that this is a statute which the Commission should assure is not unduly broad. This is, in short, precisely the sort of interstitial issue where *Chevron* deference is due the Commission's informal conclusions; "the statute itself is very complex", the Commission has long and broad "expertise in making such policy decisions," and "the importance of the agency's decisions to the administration of the statute" is critical.

The only reason to consider not according conclusive deference to the Commission's position might be that it is not a "long-standing" one. That, however, is only true in the limited sense that the claim that the indirect acquisitions are within the scope of Section 16(b) is itself an apparently novel claim. The Commission should not have to envision every novel claim that might be made under Section 16(b) and analyze these hypothetical claims, before its views will be deemed authoritative. 13/

13/ In *In re New Times Securities Services, Inc.*, 371 F.3d 68, 80-83 (2d Cir. 2004), this Court appeared to recognize that a Commission *amicus* brief might be entitled to *Chevron* deference, but declined to give it such deference because of the Commission's failure to previously address an issue even though it was longstanding. The Court also noted the presence of a competing view by an

(continued...)

In a broader sense, moreover, the analysis here is closely similar to the sort of analysis the Commission has repeatedly engaged in for many years. The Commission has over the decades analyzed which transactions do not present risk within the purposes of Section 16(b). 14/ Consistent with its rulemaking authority, the Commission has emphasized in both rules and *amicus* briefs that liability should exist only in situations where there is a real risk of insider trading. 15/

The Commission's *amicus* position here satisfies the other requirements for *Chevron* deference. It is the product of careful consideration, and is the authoritative view of the Commission itself, not merely staff views. The Commission's Office of the General Counsel posted to the Commission's Web site a statement regarding consideration of *amicus* briefs. In relevant part, it states that after a request is made:

13/(...continued)
entity that administers the provision on a day to day basis, and the relation of the Commission to that entity. None of those facts exist in this case.

14/ *See, e.g., Rules* 16a-9 through 13 and 16b-1 through 16b-8, 17 C.F.R. 240.16a-9 to 16a-13 and 16b-1 to 16b-8.

15/ *See, e.g., Ownership Reports and Trading By Officers, Directors and Principal Securities Holders*, Exchange Act Rel. No. 28869, 56 Fed. Reg. 7242, 7252 (Feb. 21, 1991); *Brief of the Securities and Exchange Commission, Amicus Curiae, in Support of the Appellee on Issues Addressed*, at 23-24; *Levy v. Southbrook International Investments, Ltd*, 263 F.3d 10 (2d Cir. 2001); *Brief of the Securities and Exchange Commission, Amicus Curiae* at 13-14, *Gryl v. Shire Pharmaceuticals Group PLC.*, 298 F.3d 136 (2d Cir. 2002).

> The Office of the General Counsel will review the materials submitted and seek input from Divisions and Offices of the Commission that may have an interest in the case. In cases where further review is appropriate, the staff generally will contact both sides and offer them the opportunity to make further submissions in writing, in person, or by telephone. If the staff determines that *amicus* participation is merited in a particular case, the Office of the General Counsel will make a recommendation, together with interested Divisions and Offices, to the Commission. The Commission then considers and votes on whether to accept the recommendation and file a brief. This process can take a significant amount of time.

Request for Commission Amicus Participation in a Pending Case, posted at http://www.sec.gov/litigation/briefs/amicusrequest.htm. *Amicus* briefs submitted by the Commission thus represent the views of the Commission. *See e.g.*, David S. Ruder, *Address: The Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 Wis. L. Rev. 1167 (1989). All of these steps were taken in this case.16/ Even when denying deference to a Commission *amicus* brief on other grounds, this Court has said it had "no reason to doubt that the SEC's interpretation was the product of careful consideration." *In re New Times Securities Services, Inc.*, 371 F.3d at 82.

16/ The Commission's staff had detailed meetings with both sides' counsel, made further inquiries of them and received responses, and prepared a detailed written analysis and recommendation. The Commission reviewed the recommendation for three weeks, met and discussed it, and then voted to authorize the brief. It also reviewed the brief itself.

The statutory interpretation in this brief is an authoritative and fully considered position by the Commission, which reasonably construes an ambiguous statutory provision whose interpretation was explicitly entrusted by Congress to the Commission. We believe that the views expressed in this brief are entitled to *Chevron* deference.

CONCLUSION

The judgment of the district court should be affirmed and the positions of the Commission urged above should be adopted by the Court.

Respectfully submitted,

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February, 2006

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 05-0115-cv

AT HOME CORPORATION,

Plaintiff - Appellant,

v.

COX COMMUNICATIONS, INC., COX@HOME, INC., COMCAST CORPORATION, COMCAST ONLINE COMMUNICATIONS, INC., COMCAST PC INVESTMENTS, INC., BRIAN L. ROBERTS and DAVID M. WOODROW,

Defendants - Appellees.

CERTIFICATE OF COMPLIANCE WITH F.R.A.P. 32(a)

I certify that THE BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, SUBMITTED AT THE REQUEST OF THE COURT complies with the type-volume requirements of Rules 32(a)(7)(B) and 29(d) of the Federal Rules of Appellate Procedure (F.R.A.P.) because it contains 6988 words. I further certify that this brief complies with the typeface requirements of F.R.A.P. 32(a)(5) and the type style requirements of F.R.A.P. 32(a)(6) because it has been prepared in proportionally-spaced typeface using WordPerfect (version 11) in garamond 14-point font size.

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CERTIFICATE OF COMPLIANCE WITH LOCAL RULE 32(a)(1): BRIEFS IN DIGITAL FORMAT

I certify that THE BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, SUBMITTED AT THE REQUEST OF THE COURT, as submitted in digital format, has been scanned for viruses using McAfee VirusScan version 8.0 with signature 4692 of February 8, 2006 and that no viruses have been detected as required by Local Rule 32(a)(1).

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CERTIFICATE OF SERVICE

I, Allan A. Capute, am a member of the bars of Maryland and the District of Columbia, and I hereby certify that on 9th day of February, 2006, I caused to be served two copies of the BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, SUBMITTED AT THE REQUEST OF THE COURT, to counsel for the parties of record at the address below, by overnight Federal Express:

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