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Scalia's Deference Argument Could Have Dramatic Effects

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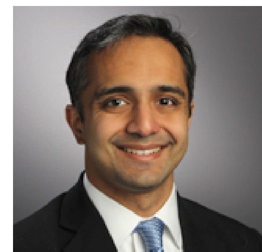
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When the U.S. Supreme Court declines to review one of the thousands of cases presented to it each year, it typically does so in silence. So, when Justice Antonin Scalia penned a rare comment accompanying one such denial last week, it naturally captured the attention of court watchers. The comment — which was joined by Justice Clarence Thomas — should also catch the attention of the U.S. Securities and Exchange Commission and those who may find themselves in that agency's line of fire.

Simply put, Justice Scalia questioned whether courts should defer to an agency's interpretation of a law that is subject to both criminal and administrative enforcement — and implicitly invited litigants to mount challenges to long-standing jurisprudence holding that courts should indeed defer. If a litigant were to take up Justice Scalia's invitation to pursue his line of argument and prevail, it could mean that the SEC will lose a key advantage of its new plan to bring more enforcement actions on its own turf in administrative proceedings, that courts will interpret ambiguities in the securities laws in favor of defendants fighting back against the SEC, that the SEC's war on insider trading will be made substantially more difficult, and that the SEC will face an uphill battle making and defending the rules that it is required to promulgate.

In Whitman v. United States,[1] the Supreme Court denied a criminal defendant's petition for a writ of certiorari challenging his insider-trading conviction in a trial before Judge Jed Rakoff. The Second Circuit, in affirming defendant Whitman's conviction, cited a prior Second Circuit decision in which the court held that a defendant commits insider trading in violation of Section 10(b) of the Securities Exchange Act of 1934 when he trades "'while in knowing possession of nonpublic information material to those trades.'"[2] The Second Circuit's earlier ruling was based in part on the court's deference to SEC Rule 10b5-1,[3] which purports to interpret Section 10(b) by adopting the knowing possession standard for insider-trading liability.[4]

Defendant Whitman filed a petition for a writ of certiorari with the Supreme Court raising a number of issues, but not seeking review of the Second Circuit's deference to the SEC's interpretation of Section 10(b) in Rule 10b5-1.[5] While the Supreme Court denied the petition with no noted dissent, Justice Scalia issued an unusual statement, joined by Justice Thomas, respecting the denial of the petition. According to Justice Scalia, the Whitman case could have presented the question whether "a court owe[s] deference to an executive agency's interpretation of a law that contemplates both criminal and administrative enforcement."[6]

Thirty years ago, the Supreme Court ruled in Chevron USA Inc. v. Natural Resources Defense Council Inc.[7] that, if a statute administered by a federal agency does not squarely address an issue, the agency's interpretation of the statute's ambiguity is entitled to deference by the courts so long as it is reasonable.[8] The Supreme Court subsequently extended the holding of Chevron to afford deference to an agency's interpretations of its regulations as well.[8] The federal appellate courts have, for nearly two and a half decades, afforded Chevron deference to "a variety of laws that have both criminal and administrative applications."[10]

But, as Justice Scalia noted, such deference runs counter to the "rule of lenity," which "requires interpreters to resolve ambiguity in criminal laws in favor of defendants."[11] Most importantly, Justice Scalia asserted that a number of Supreme Court cases have held "that, if a law has both criminal and civil applications, the rule of lenity governs its interpretation in both settings."[12] Accordingly, Justice Scalia suggested that agencies should not be given Chevron deference when interpreting such a law, and if anything, ambiguities should be drawn against the agency under the rule of lenity.

Of course, a statement respecting a denial of certiorari is in no sense precedential or otherwise binding on lower courts; indeed, Justice Scalia acknowledged (but dismissed) a footnote in an earlier Supreme Court decision that cuts against his argument.[13] Moreover, Justice Scalia did not mention that he seemingly took a different view when, in 2002, he joined a unanimous decision, SEC v. Zandford, holding that the SEC's interpretation of Section 10(b) was entitled to deference.[14] Nonetheless, Justice Scalia has provided an important cue for future litigants to raise the rule of lenity issue, and the persuasive force of his argument will not be lightly dismissed.

If adopted, Justice Scalia's reasoning could have dramatic effects on the SEC (and other similarly situated federal agencies) in several respects.

First, were Justice Scalia's position to become the law, it would eliminate one of the major tactical advantages for the SEC when it brings an enforcement action in an administrative proceeding, rather than in district court. The SEC recently has stated that it intends to bring more of its actions in administrative proceedings,[15] where deference is granted to agency interpretations of ambiguous statutes or rules rendered in the context of formal agency adjudication.[16]

Far less deference (if any) is afforded to agency interpretations advanced as litigation positions in enforcement actions brought in federal district court,[17] while, by contrast, federal appellate courts reviewing SEC administrative adjudications often have deferred to the commission's interpretations in those adjudications.[18] Eliminating Chevron deference whenever the law in question potentially could give rise to criminal liability would negate this advantage of the SEC's new litigation approach.

Second, the rationale underlying Justice Scalia's argument would not be limited in its application to Section 10(b) claims. Liability may be either civil or criminal under virtually every provision of the laws administered by the SEC, be it the Securities Act of 1933,[19] the Securities Exchange Act of 1934,[20] the Investment Company Act,[21] the Investment

Advisers Act of 1940,[22] or the Foreign Corrupt Practices Act.[23] Thus, under Justice Scalia's reasoning, the SEC would be afforded no deference in its interpretation of any of these provisions.

Third, in federal court litigation brought by the SEC, the rule of lenity would take on increased significance, with ambiguities in the statutes and rules being interpreted against the SEC in favor of the defendant. The rule of lenity isn't applied to pure civil enforcement proceedings,[24] and thus the SEC almost never has had to grapple with it in its litigation. But Justice Scalia effectively has invited every defendant in an SEC action to invoke it. At least one commentator has detected, since Zandford, an unstated trend at the Supreme Court away from deferring to the SEC's interpretations.[25] The rule of lenity could provide a hook to bring this trend to the lower courts.

Fourth, Justice Scalia's reasoning calls into question an SEC rule that is central to the government's recent crackdown on insider trading. Section 10(b) renders it unlawful to "use or employ" a deceptive device or contrivance. Rule 10b5-1, by contrast, purports to create criminal liability when a defendant trades while "aware" of inside information, regardless of whether that information was "use[d] or employ[ed]" in the trading at issue.[26]

The Second Circuit has deferred to the SEC's rule interpreting Section 10(b), and defendant Whitman's conviction was affirmed, in part based on that deference.[27] Other federal appellate courts have reached differing conclusions about the relevant standard of culpability for insider trading.[28] Justice Scalia's invocation of the rule of lenity and Judge Thomas' joining him strongly suggest that at least two justices are unlikely to uphold Rule 10b5-1 in its entirety as a faithful interpretation of Section 10(b).

Fifth, Justice Scalia's importation of the rule of lenity into the review of agency rule-making could, if adopted, greatly increase the difficulty of the SEC's task of adopting, and then defending against court challenge, the hundreds of regulations required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[29] Again, a violation of nearly all, if not all, SEC regulations gives rise to at least the potential for criminal liability. It has heretofore been thought that such regulations, issued after notice and comment, would be upheld so long as they were "reasonable" interpretations of federal statutes.[30]

Justice Scalia and Justice Thomas, however, apparently would afford the agency no such deference, instead requiring the SEC to defend its rules against a rule of lenity standard under which any and every ambiguity in the statute would be resolved in favor of the regulated party. To call this a potential sea change would be an understatement.

At the conclusion of his statement in Whitman, Justice Scalia invited future litigants to raise the issue of the amount of deference owed to executive agencies' interpretations of laws that contemplate both criminal and civil enforcement. It is a safe to assume, particularly given current trends in SEC enforcement, that someone will take him up on it.

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[1] No. 14 -29, 574 U.S. ___ (2014).

[2] United States v. Whitman, 555 F. App'x. 98, 107 (2d Cir. 2014) (quoting United States v. Royer, 549 F.3d 886, 899 (2d Cir. 2008)).

[3] Royer, 549 F.3d at 899 (citing Chevron).

[4] 17 C.F.R. § 240.10b5-1(b) (providing that a securities trade is deemed "on the basis" of material nonpublic information if the trade was made by a person "aware" of such information at the time of the trade).

[5] Petition for Writ of Certiorari, Whitman, No. 14-29. The Second Circuit's deference to the SEC's "knowing possession" rule was referenced in a footnote to Whitman's petition for a writ of certiorari. See id. at 18 n.2.

[6] Whitman, 574 U.S. ___, slip op. at 1 (Scalia, J., respecting the denial of certiorari).

[7] 467 U.S. 837 (1984).

[8] Id. at 843-44.

[9] Auer v. Robbins, 519 U.S. 452, 462 (1997).

[10] Whitman, slip op. at 1.

[11] Id. at 2.

[12] Id. at 3 (citing Leocal v. Ashcroft, 543 U.S. 1, 11-12, n.8 (2004); United States v. Thompson/Center Arms Co., 504 U.S. 505, 518 n.10 (1992) (plurality op.); id. at 519 (Scalia, J., concurring in judgment)).

[13] Id. at 2-3 (citing Babbitt v. Sweet Home Chapter, Comtys. for Great Ore., 515 U.S. 687, 704 n.18 (1995)).

[14] SEC v. Zandford, 535 U.S. 813, 819-20 (2002) (holding that the SEC's "interpretation of the ambiguous text of § 10(b), in the context of formal adjudication, is entitled to deference if it is reasonable"). Zandford did not discuss the defendant's argument there that Chevron deference was inappropriate in part because Section 10(b) "can also serve as the basis for a criminal prosecution." Brief for the Respondent, SEC v. Zandford, No. 01-147, 2002 WL 405094, *44 (2002).

[15] Jean Eaglesham, SEC Is Steering More Trials to Judges It Appoints, WALL ST. J., Oct. 21, 2014.

[16] Christensen v. Harris Cnty., 529 U.S. 576, 587 (2000).

[17] Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 212 (1988); Bradley George Hubbard, Comment, Deference to Agency Statutory Interpretations First Advanced in Litigation? The Chevron Two-Step and the Skidmore Shuffle, 80 U. CHI. L. REV. 447 (2013).

[18] See, e.g., Altman v. SEC, 666 F.3d 1322, 1326 (D.C. Cir. 2011); Geman v. SEC, 334 F.3d 1183, 1192 (10th Cir. 2003); Markowski v. SEC, 274 F.3d 525, 529 (D.C. Cir. 2001).

[19] Securities Act § 24, 15 U.S.C. § 77x.

[20] Securities Exchange Act § 32, 15 U.S.C. § 78ff.

[21] Investment Company Act § 49, 15 U.S.C. § 80a-48.

[22] Investment Advisers Act § 217, 15 U.S.C. § 80b-17.

[23] Securities Exchange Act § 32, 15 U.S.C. § 78ff.

[24] See Carter v. Wells-Bowen Realty, Inc., 736 F.3d 722, 729 (6th Cir. 2013) (Sutton, J., concurring).

[25] See Steven J. Cleveland, Resurrecting Court Deference to the Securities and Exchange Commission: Definition of "Security," 62 CATH. U. L. REV. 273, 276 (2013) ("Recently, without explanation, the [Supreme] Court has seemingly deviated from its precedent favoring deference to the SEC's interpretation of statutory ambiguity.").

[26] 17 C.F.R. § 240.10b5-1(b).

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[27] Royer, 549 F.3d at 899 (citing Chevron); see also United States v. Dombrowski, 2014 WL 3454320 (N.D. Ill. July 15, 2014) (same).

[28] See SEC v. Adler, 137 F.3d 1325 (11th Cir. 1998); United States v. Anderson, 533 F.3d 623 (8th Cir. 2008).

[29] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[30] Christensen, 529 U.S. at 587.