19-3272-cv

United States Court of Appeals

for the

Second Circuit

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

– v. –

ALPINE SECURITIES CORPORATION,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

PAGE PROOF BRIEF FOR DEFENDANT-APPELLANT (REDACTED)

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FEDERAL RULE OF APPELLATE PROCEDURE 26.1 DISCLOSURE

Defendant-Appellant Alpine Securities Corporation ("Alpine") states that its parent company is SCA Clearing, LLC and that there is no publicly held corporation owning 10% or more of Alpine.

STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

This action was commenced on June 5, 2017 through the filing of a complaint by the Securities and Exchange Commission ("SEC") against defendant Alpine Securities Corporation ("Alpine"), a Utah self-clearing broker, alleging violations of the Suspicious Activity Reporting ("SAR") requirements of the Bank Secrecy Act ("BSA"). Compl. [Dkt. 1].

On October 9, 2019, the district court entered a final judgment in favor of the SEC on its claims, and entered a permanent injunction and civil money penalty in the amount of $12,000,000 against Alpine ("Final Judgment"). [Dkt. 241].

Alpine timely filed a notice of appeal from the Final Judgment and interlocutory rulings and orders on October 10, 2019. [Dkt. 243]. This Court has appellate jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT IN SUPPORT OF ORAL ARGUMENT

Alpine submits that oral argument is necessary to address more fully a series of issues of first impression involving agency action in derogation of a Congressional delegation of authority to another agency, failure to comply with the APA, and improper employment of agency deference under the *Chevron* and *Auer* doctrines.

ISSUES PRESENTED ON APPEAL

1. Whether the District Court erred in holding that the SEC possesses authority to enforce the SAR provisions of the BSA where Congress, in a specific piece of legislation designed to address money laundering and terrorist financing applicable to a wide range of financial firms and businesses, expressly delegated administration and enforcement of the BSA to the Department of Treasury and the responsible bureau within Treasury, the Financial Crimes Enforcement Network ("FinCEN"), has consistently confirmed it possesses exclusive enforcement authority.

2. Whether the District Court erred in adopting the SEC's position that SEC Rule 17a-8, 17 C.F.R. § 240.17a-8, was able to "evolve over time" to incorporate SAR provisions of the BSA although Rule 17a-8 was promulgated in 1981, a decade before the SAR provisions were enacted by Treasury, and the SEC's claim that it could "dynamically incorporate" future legislation, without notice, comment or publication, violates both the Administrative Procedure Act ("APA"), 5 U.S.C. § 551, *et seq.*, and the Federal Register Act ("FRA"), 44 U.S.C. 1501, *et seq.*

3. Whether the district court erred in granting summary judgment for the SEC by adopting the SEC's novel theories that certain "red flag" items, culled by the SEC from bits of industry guidance, created automatic requirements for when a

SAR must be filed and for what must be included in a SAR narrative, contrary to the consistent pronouncements of FinCEN that SAR filing decisions are not governed by rigid rules but require an analysis of all of the "facts and circumstances" of a transaction.

4. Whether the district court erred, in granting summary judgment in favor of the SEC, by failing to view the evidence and all inferences in the light most favorable to Alpine, and by disregarding significant documentary evidence and testimonial evidence from Alpine's fact and expert witnesses that created disputed issues of material fact regarding Alpine's compliance with the SAR provisions of the BSA.

5. Whether the district court relied on impermissible factors and disregarded evidence in imposing an unprecedented civil money penalty of $12 million against Alpine for strict liability books-and-records violations under the Exchange Act.

Issues 1-4 were decided on summary judgment and present issues of law. This Court reviews a district court's decision on cross-motions for summary judgment *de novo*, construing the evidence with respect to each motion in the light most favorable to the non-moving party. *Narayanan v. Sutherland Global Holdings Inc.*, Nos. 18-2669, 18-2678, 19-1648, 2019 U.S. App. LEXIS 28788, at

*6 (2d Cir. Sept. 18, 2019); *Scholastic, Inc. v. Harris*, 259 F.3d 73, 81 (2d Cir. 2001).

With respect to Issue 5, a district court's imposition of a penalty is reviewed for abuse of discretion. *SEC v. Razmilovic*, 738 F.3d 14, 59 (2d Cir. 2013). Whether imposition of a penalty constitutes error because the court failed to apply the proper statutory scheme, or whether it constitutes a violation of due process is reviewed *de novo*. *Droz v. McCadden*, 580 F.3d 106 (2d Cir. 2009).

STATEMENT OF THE CASE

I. PROCEDURAL HISTORY

A. Complaint

The SEC filed its Complaint on June 5, 2017, purportedly under the strict liability books-and-records provision of the Securities Exchange Act of 1934 ("Exchange Act"), Section 17(a), 15 U.S.C. § 78q(a), and Rule 17a-8 promulgated thereunder.[1] SEC Compl. [Dkt. 1]. Although nominally brought pursuant to the Exchange Act, the SEC's claims are predicated *solely* on alleged violations of the SAR rule of the BSA, 31 C.F.R. § 1023.320, and the SEC has used this self-described "case of first impression,"[2] to pursue novel theories of supposed BSA violations. First, the SEC claimed Alpine, having *filed* SARs to report particular transactions, nonetheless violated Section 1023.320(a) because the SARs failed to include certain items of information in the narrative portion of the filing and so were allegedly "deficient."[3] Second, the SEC claimed that, where Alpine *filed* a SAR relating to a customer's deposit of stock, it violated Section 1023.320(a) where it did not *also* file an additional SAR every time any portion of that stock

[1] Alpine moved to dismiss the SEC's Complaint for lack of personal jurisdiction and improper venue, on the basis that it was a Utah company and that none of the alleged violations had any connection to the Southern District of New York. Alpine Mot. to Dismiss [Dkt. 15].
[2] SEC's Mem. in Opp. to Alpine's Mot. to Dismiss, at p. 1 [Dkt. 30].
[3] *Id.*, at ¶¶ 28-33.

was sold, even if the sale itself was not suspicious within the meaning of the BSA.[4] The SEC also alleged two more run-of-the-mill BSA violations, claiming Alpine violated Section 1023.320(b) by filing SARs late, and Section 1023.320(d) by failing to maintain certain SAR support files.[5]

B. The District Court Imposed a Bifurcated Summary Judgment Process

1. First Summary Judgment Proceedings

The SEC did not disclose, in either its Complaint or in response to written discovery requests, the alleged "deficiencies" in the SAR narratives. Alpine therefore filed a motion and sought a conference with the district court to obtain that disclosure.[6]

The district court held a conference on Alpine's motion in November of 2017, approximately one month after pleadings closed. At the conference, the district court denied Alpine's motion to compel, holding it was "not going to require the SEC to identify . . . what specific kinds of violations for that individual SAR exist" until "expert discovery."[7]

It was during that initial discovery conference that the district court devised and put in place an unusual and immediate summary judgment process. In

[4] *Id.*, at ¶¶ 34-38.
[5] *Id.* ¶¶ 39-43.
[6] *See* Alpine's Letter Motion to Compel Production [Dkt. 42].
[7] Hr'g Tr., Nov. 2, 2017, at 33:24-34:6, 38:1-11. [Dkt. 61].

response to Alpine's motion for an articulation of the claimed SAR deficiencies, the district court questioned the SEC regarding whether rules existed in relation to the content of SAR filings. *Id.* at 9: 7-9. The SEC confirmed there were "no regulations governing contents of SARs," but rather "[i]t is a collection of guidance from FINRA and . . . industry experience . . . [t]hat takes somebody from the industry, an expert for example, to opine on."[8]Alpine concurred. [9]

Notwithstanding those statements of both parties, and even though fact discovery was just beginning and the commencement of expert discovery was months away, the court *sua sponte* established an expedited schedule for a "quick summary judgment motion" to enable the court to provide "guidance" on the law and whether a "deficiency exists or not" based on "exemplar SARs."[10] Alpine immediately expressed concern that summary judgment on those issues was "premature" because issues relating to the filing of SARs under the BSA are by definition fact intensive, dependent on the facts and circumstances of a particular transaction, the customer and of the industry, and could only be evaluated in in the context of information that would be developed through lay and expert testimony.[11] The court insisted, however, that this process would not "depriv[e]" Alpine of its

[8] *Id.* at 9:11-20.
[9] *Id.* at 25:5-11.
[10] *Id.* at 23:21-24:4, 30:23-31:9, 36:17-37:3.
[11] *Id.* at 26:10-29:10, 30:14-22, 31:10-15.

"opportunity to defend the bigger point of, even if there is a deficiency with respect to individual SARs, [Alpine] had a robust process and program in place."[12]

The SEC then filed the motion for summary judgment as directed by the court, claiming that both the filing and the content of SARs were governed by "red flag" rules.[13] Alpine filed a cross-motion that addressed the critical threshold issue of whether the SEC possessed enforcement authority under the BSA, and opposed the SEC's arguments concerning "red flag" rules.[14]

In a telephonic conference on March 30, 2018, the district court confirmed that it would be issuing a "preliminary" decision "laying out what I understand the law is and was at the relevant period," and stating: "*to the extent that [the parties] have further authority to provide to [the court] on those issues, they'll feel free to do so . . . .*"[15]

The district court also stated it had not yet completed its review of Alpine's cross-motion, but would advise the parties if it felt that argument was warranted.[16]

Only hours later, the 77-page March 30, 2018 Opinion issued in which the district court granted, in part, the SEC's motion. *SEC v. Alpine*, 308 F.Supp.3d 775 (S.D.N.Y., March 30, 2018) ("March Op.") [Dkt. 101]. The district court

[12] *Id.* at 32:7-10.
[13] SEC's Mot. for Partial Summ. Jd. [Dkt. 68].
[14] Alpine's Cross-Motion for Summ. Jd. [Dkt. 83] and Mem. in Opp. to SEC's Mot. for Summ. Jd. [Dkt. 87].
[15] Hr'g Tr., March 30, 2018 at 11:18-24 (emphasis added) [Dkt. 108].
[16] *Id.* at 17:19-20.

expressly acknowledged it was the SEC's burden to establish that each of the SARs at issue were required to be filed under 31 C.F.R. § 1023.320, and found the SEC *failed* to satisfy that threshold element of its claim.[17] Instead of denying the SEC's motion, however, the Court proceeded apace to grant "partial summary judgment," endorsing the SEC's theories and creating entirely new SAR filing and content requirements that were disconnected from any consideration of the facts relating to the transactions at issue.[18] In some instances, the district court *sua sponte* remade the SEC's claim, ruling in the SEC's favor on arguments it did not even make.[19]

Even as it created new SAR requirements, the district court acknowledged it lacked "lay and/or expert testimony" on "the penny stock market, and manipulation of that market, as well as various other market practices," noting that the parties' failure to provide expert testimony was likely due to the Court's scheduling of the motions months before expert discovery.[20]

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[17] March Op., at 46 [Dkt. 101].

[18] *Id.* (stating the ruling will "assume" the filings were required without reaching this "contested issue," but then granting summary judgment on behalf of the SEC).

[19] For example, while the SEC argued that filing a SAR on a deposit of stock automatically required the filing of another SAR to report a sale of that stock, the court came up with a different approach, holding that a large deposit and sale of low-priced securities constitutes a suspicious "pattern" of activity that requires SAR reporting under Section 1023.320(a)(2). *See* March Op., 65-69 [Dkt. 101].

[20] *Id.* at 46, n.21.

In remarkably terse fashion, the district court denied Alpine's cross-motion. *Id.* at 34-38. The court declined to consider or even acknowledge the clear and detailed history and content of the BSA, the express and incontrovertible delegation of enforcement authority exclusively to Treasury, or the extensive case law that demonstrated the SEC lacked that authority.[21] The Court also held, without citation to any authority, that the SEC had managed to incorporate into its 1981 issuance of Rule 17a-8 all subsequently enacted provisions of the BSA – without a need to comply with the APA for the new obligations.[22]

Based on the district court's failure to acknowledge the controlling authority regarding BSA enforcement, the court's description of its decision as "preliminary," its concern regarding the lack of lay and expert testimony, and its invitation to the parties to provide additional authority, Alpine sought reconsideration of the district court's decisions.[23] Alpine accompanied these filings with a motion for leave to file relevant testimony that was not previously available because of the peculiar briefing schedule set by the court, including a declaration from Alpine's expert witness, Beverly E. Loew, a former FinCEN employee; deposition testimony from current and former Alpine employees that

[21] *Id.*
[22] *Id.* at 37-38.
[23] [Dkt. 110, 112].

countered various factual assumptions made by the court; and additional SARs that rebutted the claim that Alpine had failed to prepare and file detailed SARs.[24]

On the first business day after the motion was filed, without waiting for any response from the SEC, the district court denied Alpine's motion for leave to file additional testimony and evidence with a single word: Denied.[25] On June 18, 2018, the district court denied Alpine's motions for reconsideration, and Alpine's request for certification for interlocutory appeal, on the basis that it had already considered and rejected Alpine's arguments. Order, Denial of Mot. for Recon., [Dkt. 129].[26]

2. Second Summary Judgment Proceedings

As it turned out, Alpine's concerns about the "quick summary judgment" process were well founded. Although the March 2018 Opinion addressed only a few exemplar SARs, and was decided on an inadequate record, that March Opinion was then successfully employed by the SEC to obtain judgment based on nothing but a check-the-box presentation. On July 13, 2018, the SEC moved for summary judgment on liability based upon "summary charts" prepared by the SEC's expert

[24] [Dkt. 115].
[25] [Dkt. 117].
[26] Alpine filed a Petition for a Writ of Mandamus with this Court on the issue of the SEC's BSA enforcement authority, on June 22, 2018. This Court denied the Petition on September 28, 2018, holding that Alpine failed to demonstrate that it lacks an adequate, alternative means of obtaining relief. [Dkt. 170].

consulting firm, Navigant Consulting, Inc.[27] With respect to both the SAR filing and the narrative requirement, the SEC relied on bright line "red flag" rules, designed to correspond to the rulings in the March 2018 Opinion. To support the SEC's claim that a filing was required, and that a narrative was deficient, Navigant simply checked the box on its chart to indicate that the "red flag" was mentioned somewhere within Alpine's support file, but was not in Alpine's SAR narrative. Similar summary charts were prepared for the "deposit-liquidation" pattern SARs. So completely had the March Opinion resolved the case, that *the SEC did not submit a single SAR or SAR support file in support of summary judgment,* despite seeking a ruling on the sufficiency of Alpine's SAR reporting.[28]

In response, Alpine disputed the SEC's theories and provided a counterfactual statement consisting of actual SARs and support files, factual and expert testimony and other evidence developed in discovery, detailing, *inter alia*, Alpine's robust AML process, its consideration of the red flag issues in making SAR filing decisions, and its program improvements – critical components of the "facts and circumstances" analysis that FinCEN has consistently stated governs. None of it mattered.

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[27] SEC's Mot. for Summ. Jd. on Liability [Dkt. 146].
[28] *See* SEC's Mot. [Dkt. 146], Mem. in Supp. [Dkt. 147], and SOF and Exhibits [Dkt. 148].

The district court issued a lengthy opinion on December 11, 2018, without oral argument, granting summary judgment in favor of the SEC, using the check-the-box approach for both the SAR filing requirement *and* the content of the narrative. *See SEC v. Alpine*, 354 F.Supp.3d 396 (S.D.N.Y., December 11, 2018) ("December Op.") [Dkt. 174].[29] The court disregarded Alpine's substantial evidence regarding its process, instead implementing its "preliminary" analysis from the March Opinion that was made without the benefit of factual or expert testimony. The specific rulings and errors in these summary judgment rulings are detailed in the argument, below.

C. Remedies Proceedings

The SEC filed its Motion for Remedies on May 3, 2019, seeking the entry of a permanent injunction and "tier 1" civil penalties under Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3), in the amount of $22,736,000, calculated at $10,000 per SAR violation and $1,000 per support file violation. SEC Remedies Mem., at 2 [Dkt. 197]. The district court declined to hold an evidentiary hearing and issued a written decision on September 26, 2019, entering a permanent injunction and a $12 million penalty against Alpine. *See* Court's Opinion and Order [Dkt. No. 235].

[29] The court denied summary judgment on all the allegedly late filed SARs on the basis that the SEC failed to establish they were required filings. *See* December Op., at 96 [Dkt. 174].

D. Motion for Reconsideration Based on the Supreme Court's Decision in *Kisor v. Wilkie*

On June 26, 2019, in the midst of the remedies briefing, the Supreme Court issued its decision in *Kisor v. Wilkie*, 139 S.Ct. 2400 (2019), limiting and redefining the doctrine of *Auer* deference. Because the district court had relied heavily on concepts of agency deference in resolving the issues on summary judgment, Alpine again sought reconsideration.[30]

The district court denied Alpine's request, holding that *Kisor* did not alter the law regarding *Auer* deference, or any of its analyses or conclusions on summary judgment.[31]

E. Entry of Final Judgment and Prior Proceedings on Appeal

The district court entered Final Judgment on October 9, 2019.[32] Alpine timely filed a notice of appeal from the Final Judgment, and all interlocutory rulings and orders, on October 10, 2019.[33]

Alpine filed an Emergency Motion to Stay the Judgment Pending Appeal on October 10, 2019 and sought an expedited appeal. The SEC opposed both

[30] *See* Alpine's Mot. to Reconsider [Dkt. 209].
[31] *See* Court Order [Dkt. 224].
[32] Final Judgment [Dkt. 241].
[33] Notice of Appeal [Dkt. 243].

requests.[34] On November 21, 2019, this Court stayed the entire judgment pending appeal, and expedited the appeal.[35]

II. STATEMENT OF FACTS

A. Evidence Concerning Alpine's Compliance Program and SAR Filings

1. Alpine's Development of its Compliance Program

The allegations in this case date back to May of 2011, just two months after Alpine was acquired by present ownership. At the time of that acquisition, Alpine had no legal personnel and only limited compliance staff [36] and the evidence demonstrated that it set about hiring legal and compliance personnel. Elisha Werner, an attorney, was immediately hired.[37] Alpine brought in additional attorneys, including Betsy Voter who later became General Counsel, and it retained Bingham McCutchen and Sidley Austin as the firm's outside counsel,[38] available at all times to assist the staff with compliance issues.[39] The hiring process continued in 2012 when Alpine was able to persuade Leia Farmer to accept

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[34] [USCA Dkt. 17].
[35] Order of USCA [Dkt. 67].
[36] *See* Declaration of Maranda Fritz in Opposition to the SEC's Motion for Remedies ("Fritz Decl.") [Dkt. 206], Ex. 1 (Angotti Dep.), at 336; *see also* Alpine's Additional Statement of Facts in response to the SEC's Motion for Summary Judgment on Liability ("Alpine's Add'l SOF"), ¶ 77 [Dkt. 154].
[37] Alpine's Add'l SOF, ¶¶ 77, 239 [Dkt. 154].
[38] *See* Fritz Decl. [Dkt. 206] Ex. 2 (Alpine Dep.), at 62-63; *id.* Ex. 3 (R. Jones Dep.), at 18; *id.* Ex. 4 (T. Groskreutz OTR), at 94-95; *id.* Ex. 5 (L. Farmer Dep.), at 65 and Alpine's Add'l SOF, ¶¶ 80, 114 [Dkt. 154].
[39] *See* Fritz Decl. [Dkt. 206] Ex. 4 (T. Groskreutz OTR), at 94-95 and Alpine's Add'l SOF, ¶¶ 80, 84 [Dkt. 154].

a compliance position at Alpine and move to Salt Lake City.[40] Ms. Farmer had 13 years' experience in the securities industry including serving as a Chief Compliance Officer ("CCO") and Anti-Money Laundering ("AML") Officer for other firms.[41] At Alpine, Ms. Farmer continued efforts to ensure that Alpine was in compliance with its AML obligations, and made further improvements to Alpine's AML Program that included bringing in a surveillance team, creating an AML analyst position, focusing on training activity, expanding the AML personnel, refining its policies and procedures, and having members of the AML team become ACAMS certified.[42]

2. Alpine's Section 5 and AML Process

In terms of the operation and components of its AML program, the firm had assessed and fully appreciated the primary risks associated with its business line in the microcap markets, *i.e.*, market manipulation and sale of unregistered securities in violation of Section 5.[43] Consistent with the risk assessment, the firm developed a comprehensive Section 5 review process designed to ensure that securities were, in fact, freely tradeable and that the firm would not be facilitating any sale of

[40] Alpine's Add'l SOF, ¶¶ 81-82 [Dkt. 154].
[41] *See* Fritz Decl. [Dkt. 206] Ex. 5 (L. Farmer Dep.), at 7-10 and Alpine's Add'l SOF, ¶ 82 [Dkt. 154].
[42] Alpine's Add'l SOF, ¶ 108 [Dkt. 154].
[43] *Id.* ¶¶ 118-135, 225-230.

unregistered securities.[44] Every deposit was subject to a thorough review consistent with the questions raised in FINRA Regulatory Notice 09-05[45] including receipt and review of complete documentation concerning how and when the shares were acquired.[46] Where a registration statement was in place relating to the securities, Alpine reviewed the transaction to ensure that the purchase and sale by the customer met the requirements of the registered offering.[47] For securities that were not the subject of a registration statement, Alpine reviewed the exemptions relied on by the customer, e.g., Rule 144, Section 4(a)(1), and Section 3(a)(10), to ensure that the shares were eligible for resale.[48] Notably, the SEC's expert admitted during her deposition that she was unable to locate *any* Section 5 violations in any of the transactions at issue.[49]

In conjunction with this account opening and Section 5 analysis, Alpine reviewed incoming deposits for AML issues, including suspicious activity reporting.[50] Where the due diligence material referenced one of more AML issues, that was noted in an initial review by a compliance analyst and a SAR was

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[44] *Id.* ¶¶ 118-135.
[45] FINRA Notice 09-05 provides guidance for broker-dealers regarding the legal requirements and issues surrounding unregistered resales of restricted securities. Notice 09-05 is available at https://www.finra.org/rules-guidance/notices/09-05.
[46] *Id.* ¶¶ 27-58, 217-230.
[47] *Id.* ¶ 122.
[48] *Id.* ¶ 123.
[49] *Id.* ¶ 135.
[50] *Id.* ¶¶ 118, 121.

"prepped" for further review.[51] Any AML issues, including "red flags," were then considered by compliance personnel and either resolved through analysis or included in a SAR filing as appropriate.[52]

3. Alpine's SAR Filings

Even from the early timeframe of 2011 through 2012, Alpine filed detailed SARs when it determined that certain activities were suspicious and a SAR filing was required. The following is ***only a portion*** of one SAR narrative dated August 27, 2012, evidencing the comprehensive narratives filed by Alpine where it considered the transaction "suspicious" within the meaning of the BSA:

> [redacted] is a client of Alpine Securities. Alpine is a retail broker-dealer & provides clearing, execution and settlement services for correspondent firms. On or around 8/16/12 through 8/17/12, the authorized agent, [redacted] placed an order to buy [redacted] shares of [redacted], a low priced security. This account was established on 09/20/2011. [redacted] purchased the shares ranging in price from [redacted] to [redacted] on 8/16 and [redacted] on 8/17. This transaction amounted to approximately [redacted]. This SAR is being filed due to the large volume of trading activity and the potential suspicion that the individual and parties below may have had some involvement in the volume of trading activity. This information is unconfirmed, however. On 8/16/12, site www.otcmarkets.com, cited marketwire via [redacted] The article announced that an agreement from [redacted] had been signed for the purchase of two [redacted] Units, a portable hazard waste cleanup device used to help in the cleanup at [redacted]. This stock had zero volume until

[51] *Id.* ¶¶ 31, 41-42.
[52] *Id.* ¶¶ 48-56.

> 08/16/2012 and then exceeded over 300M in trading volume the same day. The stock had been trading for a short period of time with no real volume or trade level history. In a news article dated [redacted], the story referenced the considerable stock jump and immediate retreat and alleged that promoters colluded with market participants to run up the stock price. [redacted] sold [redacted] shares on 09/19/2012 for an average price of [redacted] representing a loss of approximately [redacted]. A review of [redacted] account card indicates that [redacted] is a manager and that the firm performs business consulting.[53]

In addition to Section 5 analysis and reviews, and because microcap stocks are typically thinly traded and pose a risk of manipulation, Alpine also developed and implemented a market surveillance process focused on identification of movement in share price or trading volume and any indication of wash trades, match trades, or coordinated sales.[54] Where those trading issues were observed, the matter was referred to the AML Officer for review and for consideration of a SAR filing.[55] Alpine's market surveillance activities, and the detail of its narratives where it detected activity that warranted the filing of a SAR, are reflected in the SAR below:

> On or around 08/22/14, Alpine performed a review of trading activity for [redacted] and found the following activity to be potentially suspicious: [redacted] is a client of Scottsdale Capital, a firm for which Alpine Securities provides securities clearing

[53] Alpine Add'l SOF, ¶ 89(c) [Dkt. 154] and Exs. 22-54 to Fritz Decl. [Dkt. 153] for multiple examples of detailed SARs filed during 2011 and 2012.
[54] Alpine Add'l SOF, ¶¶ 224-230 [Dkt. 154].
[55] *Id.* ¶¶ 225-227.

services. Between 8/15/2014 - 8/21/2014, [redacted] sold [redacted] shares of [redacted] a low-priced security for an approximate aggregate gain of [redacted] (trade details below) AccountName Symbol TransactionType TradeDate Shares Sold Price [redacted] These sales accounted for 34.52% of [redacted] total market volume during the three day period, or [redacted] shares sold of the [redacted] total amount traded for the date range. The client's daily volume percentages of shares sold are listed below: Date Shares Sold % of daily trade volume 8/19 [redacted] 47.54% 8/20 [redacted] 45.93% 8/21 [redacted] 24.72 % [redacted] selling activities appear to have placed downward pressures on the closing prices of [redacted], meaning the sales influenced the price of the stock which was reflected by the price at the end of the trading day. Prior to [redacted] activities, the closing price of [redacted] was [redacted]. Then, when the client sold [redacted] shares on 8/19/2014 the closing price dropped 25% to [redacted]. Alpine is filing this SAR due to the large percentage of [redacted] trading volume [redacted] shares represented, which in turn appeared to have potentially influenced the price, which could suggest that [redacted] attempted to dominate the market for the security.[56]

4. Alpine's Other Non-Mandatory SARs

As it was building and expanding its compliance function in 2011 and into 2012, Alpine and its compliance personnel also had to address the specific issues concerning deposits of low-priced securities, including attempting to navigate through oftentimes inconsistent forms of guidance, publications and communications from regulators.[57] Based on publications such as FINRA

[56] Alpine Add'l SOF, ¶ 230(c) [Dkt. 154] (citing SAR No. 250).
[57] *Id.* ¶¶ 65-72, 246 [Dkt. 154].

Regulatory Notice 09-05 and specific discussions with FINRA personnel, Alpine developed a practice of filing SARs to report all large deposits of low-priced securities, regardless of whether it considered the transaction to be "suspicious," *i.e.*, indicative of criminal activity.[58] Multiple witnesses have testified to this practice, and Alpine discussed that procedure in its response to a FINRA examination report in October 2012.[59]

Because those SARs were filed by Alpine on deposits that, in Alpine's view, were not indicative of criminal activity, those SARs would be considered voluntary as opposed to mandatory SAR filings.[60] Those SARs were markedly different from the ones quoted above, with narratives that contained only a description of the actual stock deposit, and frequently cited Alpine's "policy" of filing SARs on large deposits.[61] Those types of SARs, filed during 2011 and 2012, comprised a substantial portion of the alleged violations in this case.[62]

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[58] Alpine's Add'l SOF, ¶¶ 60-75, 88 [Dkt. 154] (testimony regarding Alpine's filing of voluntary and template SARs).

[59] *See generally id.* ¶¶ 60-74 (including statements from Leia Farmer that Alpine "routinely" filed SARs on large deposits it did not find suspicious, and during Alpine's 30(b)(6) deposition that Alpine "very often" filed voluntary SARs). *Id.* ¶ 75(a)-(m) (detailing statements from Alpine's Expert regarding the filing of voluntary SARs).

[60] The SAR regulation expressly allows the filing of such non-mandatory SARs. 31 C.F.R. § 1023.320(a)(1).

[61] *See* Alpine Add'l SOF, ¶¶ 60-74 [Dkt. 154].

[62] *Id.* ¶¶ 93-96, 177(a).

5. The 2012 FINRA Examination and Alpine's Prompt Remediation

Although Alpine had filed those voluntary SARs based on communications with FINRA, the 2012 FINRA examination report criticized SARs that reported a deposit but provided little additional discussion or any basis for believing that the transaction was suspicious.[63] In its response, Alpine explained the inconsistent views and guidance that it had received in relation to deposits of low-priced securities and the Catch 22 that existed in relation to microcap securities.

> Alpine, like other broker dealers, must often choose between filing SARs when there is no indicia of suspicious activity other than activity that in general has been the subject of scrutiny of FINRA, such as activity in low-priced securities, and not filing at all and risking backward-looking criticism.[64]

Ms. Farmer described this concern as a "balancing act" between "filing for everything" and not filing and having it "questioned later," and explained that Alpine felt "it needed to perform these types of filings based on feedback it has received in the past from FINRA."[65]

Alpine also immediately took steps to address FINRA's criticism of the SAR narratives, changing its practices in ways that are evident even from the SEC's own presentation in this case.[66] The SEC's expert, when asked about

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[63] *Id.* ¶¶ 66, 72, 96-98.
[64] *Id.* ¶ 67 (citing L. Farmer's discussion of the FINRA examination).
[65] *Id.*
[66] *Id.* ¶¶ 92-94.

"changes or developments in Alpine's AML program during that period" in 2012 forward, responded that "I think they got a new compliance officer around that time, a new AML compliance officer."[67] She confirmed also that Alpine addressed and corrected the deficiency cited by FINRA of "inadequate" narratives.[68] In her report, the SEC expert identified that same issue, which she referred to as "the 5Ws,"[69] *i.e.*, a failure to articulate the reason for the filing. According to her analysis, beginning in the third quarter of 2012 and continuing through the end of the relevant period in December of 2015, that deficiency all but disappeared. Of the 1,015 SARs which the SEC's expert claims were insufficient on their face for failing to include the so-called "5 Ws," only twenty (20) were filed in the 3 years after Alpine received FINRA's 2012 examination report.[70] Based on her own data, the SEC expert stated: "I saw improvements in the quality of the SARs as time went by and, in fact, some that were very late in the period we didn't find any omissions at all."[71]

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[67] *See* Fritz Decl. [Dkt. 206] Ex. 1 (Angotti Dep.), at 266.
[68] *Id*. at 308-309, 337-338, 340-342 (Alpine's Add'l SOF, ¶ 92 [Dkt. 154]).
[69] The "5Ws" or "essential elements" category, derived from a "best practices" type of publication from FinCEN that suggested that broker dealers discuss the "who what when where and why" of the transaction. Alpine's expert explained that specific sections of the SAR form call for information regarding the "who what when and where," and leaving the "why" to be addressed in the narrative, and Alpine included all that information. More importantly, that kind of generalized industry advise or guidance does not create a violation of the BSA.
[70] Alpine Add'l SOF, ¶ 94-96 [Dkt. 154]; *see also* Ex. A to SEC's Expert Report, Subcategory Quarterly Chart, attached as Ex. 55 to Alpine's Add'l SOF, ¶ 94 [Dkt. 154].
[71] *Id.* ¶ 92 [Dkt. 154].

Notably, FINRA's Report of Examination for 2012 did *not* refer to any "red flag" requirements and FINRA took no action against the firm relating to Alpine's 2011 or 2012 SAR filings.[72] *Id.* ¶ 90, 98. Thus, Alpine corrected the issue raised by FINRA of "inadequate" narratives while continuing to understand that its SAR narratives should consist of the pertinent details of the transaction and the reason for the firm's filing, *i.e., why the broker-dealer believes the activity falls within the BSA categories and what is unusual or irregular about the activity compared to the customer's other transactions.*[73]

6. The SEC's Red Flag Theory

It was not until OCIE's examination in April of 2015 that Alpine was presented with the SEC's theory here, *i.e.*, that Alpine was required to include in the SAR narratives every red flag mentioned in the support file, whether relevant to its filing or not.[74] *Id.* ¶ 101. That examination report, authored by Denise Saxon

[72] This case therefore includes different allegations being leveled by the SEC regarding the same SARs that were involved in FINRA's 2011 review and as to which no action was taken, illustrating the kind of inconsistent positions that have been taken by regulators regarding SAR filing and content requirements.

[73] *Id.* ¶¶ 95-97, 100-116; *see also* SEC's Ex. A to its Expert Report, Subcategory Quarterly, attached as Exhibit 55 to Alpine's Add'l SOF [Dkt. 154].

[74] There was no prior notice, in either the FINRA or OCIE reports, of the SEC's other new theory here: that the filing of a SAR on a deposit of stock automatically required a SAR to be filed on a sale of that stock. *See* FINRA and OCIE letters to Alpine, attached as Exhibits 20 and 65 respectively to Alpine's Add'l SOF [Dkt. 154]. *This case* was the first time this theory was propounded.

in the SEC's Denver Office, employed the "red flag" theory that was then pressed in this case by Alma Angotti of Navigant, the SEC's expert.[75]

In response to the 2015 OCIE report, Alpine's legal counsel prepared a response addressing the SEC's contentions and emphasizing that no one at Alpine had ever deliberately omitted relevant information from a SAR or attempted to evade the SAR filing rules in any manner.[76] Alpine also again revised its procedures to comply with those directives.[77] And this too is borne out in the SEC's expert's analysis. After the second quarter of 2015, the SEC's expert identified only four (4) SARs total as having "deficient" narratives for failure to include red flags, and only ten (10) total after April 9, 2015 – the date Alpine received the OCIE examination report first disclosing this theory.[78]

SUMMARY OF THE ARGUMENT

The SEC's claim against Alpine for violations of the BSA is based on not just one but an aggregation of unprecedented and unsupportable assertions. First, as the purported footing for its claims, the SEC argued that it possessed jurisdiction

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[75] The court refused to permit Alpine discovery regarding that report, basing that denial on its ruling that the report was "not the source of any legal obligation or of any finding that Alpine violated Section 1023.320." Order [Dkt. 174], at 34 n. 36. Contrary to that ruling, the district court then proceeded to rely extensively on that report in its penalty determination as support for the conclusion that Alpine violated its legal obligations. *See* Remedies Order, at 10-11 [Dkt. 235].

[76] Alpine's Add'l SOF, ¶¶ 107, 114, 116 [Dkt. 154].

[77] *Id.* ¶ 116.

[78] *Id.* ¶¶ 90-96 (referencing the SEC's expert's chart, attached as Exhibit 55, that the SEC did not provide to the lower court, which shows the sharp decline of alleged violations)

to interpret *and* enforce the SAR provisions of the BSA, notwithstanding express and contrary delegation of that authority by Congress to the Department of Treasury, not to the SEC. Second, the SEC insisted that it had empowered itself to pursue BSA claims for violations of the SAR provisions by virtue of a rule, Rule 17a-8, promulgated by the SEC in 1981, 10 years before the SAR regulations even existed, and without even a semblance of compliance by the SEC with the APA and FRA in relation to those SAR provisions.

As the third level of its construct, the SEC put forth its theory, never espoused by the agency with actual authority over the BSA, that various bits and pieces of industry guidance at some point congealed into inflexible "red flag" rules pertaining to the filing and the content of SARs. Based on that newly crafted regime of rigid SAR filing and content rules, the SEC then maintained it was entitled to summary judgment notwithstanding myriad material facts in dispute concerning the transactions at issue and Alpine's review and reporting of those transactions.

Finally, the SEC added to that pile of novel contentions the further claim that the intent requirements and penalty limits Congress imposed in the BSA did ***not*** govern the alleged BSA violations, and that Alpine's alleged violations should be adjudged under the lower strict liability standard applicable to the books and

record provision of Section 17 of the Exchange Act, and penalized under its harsher sanctions.

As Alpine demonstrated in the court below, none of these components of the SEC's construct withstands analysis. Its foundational assertion of jurisdiction is flatly contrary to settled and well-reasoned Supreme Court and circuit authority, reflected and applied in this Court's decision in *Nutritional Health Alliance v. F.D.A.*, 318 F.3d 92 (2d Cir. 2003). Those authorities support only one conclusion: Congress delegated to Treasury the authority to administer and enforce the BSA, a statutory regime primarily directed at banking facilities and the movement of money for purposes of laundering and terrorist financing. That exclusive and express delegation only to Treasury precludes both the SEC's unilateral conferral of authority on itself and its usurpation of authority vested elsewhere. Once the SEC's foundational argument is assessed and dismantled, its claim falls.

Notably, even if the SEC could *sua sponte* assert enforcement authority under the BSA, each of its remaining contentions is also contrary to law. The SEC's claim that it conferred authority on itself through issuance of SEC Rule 17a-8, promulgated a decade ***before*** the relevant SAR provisions of the BSA were even created, contravenes the fundamental and essential requisites of the APA and the FRA. While the SEC now claims that its Rule 17a-8 was designed to "evolve" to

automatically absorb subsequently enacted BSA provisions, it actually promulgated Rule 17a-8 specifically to address the original CTR obligations contained in the BSA. When SAR provisions were later enacted, the SEC failed properly to consider and solicit comment on the implications of that incorporation, as required by the APA and FRA, or even notify regulated entities of its view that Rule 17a-8 suddenly encompassed SAR filing requirements. Its baseless contention in this case that it could circumvent the APA through dynamic incorporation of subsequently enacted Treasury regulations flies in the face of the essence of agency rulemaking requirements, and the prohibition against improper delegation of rulemaking authority.

The threshold issue of jurisdiction, and the proper interpretation of Rule 17a-8, are only two examples of the errors that underlie the district court's decisions. On another matter of first impression, the district court acceded to the *SEC's* new formulation of SAR filing and content requirements, adopting the SEC's bright-line test that a SAR must be filed on all transactions that involve a "large deposit of low-priced securities" plus one additional "red flag" plucked by the SEC from various and sundry forms of industry guidance. The court also held, for the first time, that a firm that *filed* a SAR had nonetheless *violated* the BSA *as a matter of law* if it failed to include in the narrative portion of the SAR a reference to any one of those red flags. It then went the additional step of deciding that the existence of

a violation could be decided on summary judgment notwithstanding the extensive evidence relating to the firm's reasons for its SAR filing decisions and its explanation of its inclusion of certain information in the narrative.[79]

In articulating this new BSA violation based on a set of "red flag" rules and a "deficient" narrative, the district court assiduously ignored the consistent statements of the agency charged by Congress with administration and interpretation of the BSA, FinCEN, that SAR filing determinations as to "suspiciousness" were "subjective" decisions and "judgment calls," and that SAR filing decisions would be evaluated on a "facts and circumstances" basis. Ignoring all of these principles and pronouncements, this district court created hard and fast "red flag" rules for SAR filings and their contents.

The error of the district court's embrace of the SEC's interpretations of Section 17 and Rule 17a-8 was underscored by the recent pronouncements of the Supreme Court in *Kisor v. Wilkie,* 139 S.Ct. 2400 (2019). In that decision, the Supreme Court dealt directly with the fact that courts had been "jumping the gun" on the use of *Auer* deference, applying it reflexively without "exhausting all of the tools of statutory construction" and without properly assessing whether the agency's interpretation was an authoritative and deliberative statement of the

[79] The rules were, in many instances, invented by the district court which rejected formulations espoused by the SEC, and fashioned new ones. *See infra* at Point III.

agency that possessed relevant expertise. That decision, although not overruling *Auer*, plainly limited its application, so much so that the concurring justices described the doctrine as "zombified."

Here, because this district court had engaged in precisely the errors that led to the reversal in *Kisor*, Alpine sought reconsideration based on *Kisor*. The district court denied reconsideration, holding that *Kisor* "affirmed the continued viability of *Auer* deference" and "did not change the law." In that decision, the district court completely disregarded the Supreme Court's explicit teachings concerning both the process by which deference should be employed, and the extent to which particular agency pronouncements may, or may not, be entitled to deference. On this basis also, the district court decision should be reversed.

The district court's ruling that the SEC possesses authority to enforce the SAR provisions of the BSA, its conclusion that the SEC had promulgated a rule that enabled it to pursue those violations, its embrace of new theories of BSA violations, its grant of summary judgment notwithstanding material disputed issues of fact, and its ultimate imposition of an unprecedented penalty based on impermissible factors– all are separate and discrete errors, each of which requires reversal of the district court's decision.

ARGUMENT

POINT I
THE SEC DID NOT RECEIVE AND DOES NOT POSSESS AUTHORITY TO ENFORCE THE SAR PROVISIONS OF THE BSA

Analysis of agency authority begins with recognition that an agency has "'only those authorities conferred upon it by Congress.'" *Natural Res. Def. Council v. Abraham*, 355 F.3d 179, 202 (2d Cir. 2004) (citation omitted); *see also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125, 161 (2000) (an agency cannot act "without a valid grant of authority from Congress" or "'in a manner that is inconsistent with the administrative structure that Congress enacted into law.'"); 5 U.S.C. §§ 558(b), 706(2)(c). Here, Congress' delegation of authority is clear: it delegated plenary authority to the Treasury Secretary to administer and interpret the BSA, including to enact SAR provisions, and to bring civil enforcement actions arising from violations of the BSA.[80] With Congress's authorization,[81] the Secretary re-delegated this authority within Treasury to the Director of FinCEN. Treasury Order 180-01(3)(a), (b); *see also* 31 C.F.R. § 1010.810(a) ("Overall authority for enforcement and compliance . . . is delegated to the Director, FinCEN.") The Treasury Department, including through FinCEN, has confirmed its exclusive enforcement and penalty authority for violations of the

[80] *See* 31 U.S.C. §§ 5321(a)(1), (a)(6), *and* (b)(2); 31 C.F.R. §§ 1010.810(d); 1010.820(f), (h); 31 U.S.C. § 5320.
[81] *See* 31 U.S.C. §§ 310(b)(2)(I), (J) *and* 321(b)(2).

BSA in formal regulation. *See, e.g.*, 31 C.F.R. § 1010.810(d) ("Authority for imposition of civil penalties for violations of this chapter lies with the Director of FinCEN"); 52 Fed. Reg. 11,436, 11,440 *cmt. 19*, 11,445 (Apr. 8, 1987) (Treasury has "*exclusive* authority to impose civil penalties under the Bank Secrecy Act") (emphasis added). FinCEN has repeatedly emphasized its retained enforcement authority, and explained the limited nature of the delegation of *examination* authority. For example, in December of 2016, FinCEN stated

> FinCEN is responsible for the overall administration and enforcement of the BSA. Although it delegates BSA compliance examination authority to other federal regulators, FinCEN retains enforcement authority, including the authority to impose CMPs [civil monetary penalties] for violations.[82]

The SEC has only a limited role in relation to the BSA: the "[a]uthority to *examine* institutions to determine compliance with the requirements of this chapter." 31 C.F.R. § 1010.810(b)(6) (emphasis added). If that examination develops evidence of a lack of compliance, the SEC then has the duty *to submit "[e]vidence of specific violations of any of the requirements of this chapter" to the Director of FinCEN*. *Id.* § 1010.810(e) (emphasis added).

The clear purpose of this provision is to allow FinCEN to retain ultimate interpretive authority and ensure consistent implementation across the financial sectors. Both the law and policy were ignored by the SEC which admitted in this

[82] Alpine's SOF, ¶ 4 [Dkt. 85]; *see also id*. ¶¶ 3, 5-9.

case that at no time has it received any "grant of authority" from "FinCEN," "Treasury" or any "other governmental authority to pursue an enforcement action, including but not limited to seeking penalties or other remedies, for violations of the BSA," including for this case against Alpine specifically.[83] In fact, the SEC has admitted it did not even comply with its duty under Section 1010.810(e) *in connection with this case*, confirming the remarkable fact that it "did not discuss any specific SARs or their content, and did not discuss interpretation of FinCEN guidance with individuals at FinCEN in connection with this case at any time."[84] It is plain that the SEC has simply tried to usurp FinCEN's authority and role in regards to broker-dealer compliance with the BSA through pure *ultra vires* action.

The specific and express delegation of BSA enforcement authority to Treasury should have been the beginning, and the end, of the inquiry concerning the extent of the SEC's authority. The district court, however, failed even to acknowledge it in its opinions.[85] It completely ignored that express Congressional

[83] Alpine's SOF, ¶ 1 [Dkt. 85].
[84] *Id*. ¶ 2 [Dkt. 85].
[85] A telling illustration of the district court's error was its response to Alpine's Motion for Reconsideration of the denial of Alpine's Cross-Motion for Summary Judgment [Dkt 111]. In asserting the correctness of its original ruling, the court relied entirely on a particular FinCEN issuance, claiming that FinCEN acknowledged the SEC's authority to "use Rule 17a-8 to bring actions such as this one." Order [Dkt. 129] at 4. However, the FinCEN issuance on which the court relied states *precisely the opposite*. *See id.* at 4-5 (referring back to the March Op., Order at 39 [Dkt. 101]. That notice explains that, under Rule 17a-8, the SROs have authority "*to examine* for BSA compliance," not for enforcement. *Id*. (emphasis added). The district court repeated the same contention in denying Alpine's Motion for Reconsideration in light of *Kisor*.

delegation of authority in the BSA, and instead looked only to the grant of authority to the SEC contained in the Securities Exchange Act of 1934.[86] The district court acknowledged that "FinCEN has not expressly delegated BSA enforcement authority to the SEC," but concluded this was immaterial because "[t]he SEC has its own independent authority to require broker-dealers to make reports, and has enforcement authority over those broker-dealer reporting obligations" under Section 17(a) of the Exchange Act.[87] Based solely on consideration of the Exchange Act, the district court held that the SEC put forth "a reasonable interpretation of Section 17(a)."[88]

By that ruling, the district court contravened basic principles of statutory construction, improperly employed *Chevron* deference, and refused even to acknowledge dispositive authority including this Court's decision in *Nutritional Health*. As an initial matter, Section 17(a) obviously does not refer to the BSA; it does no more than empower the SEC to require maintenance of books and records in "furtherance of the purposes of" the *Exchange Act*. 15 U.S.C. § 78q(a)(1). Congress plainly did not confer on the SEC authority over the enforcement of the sweeping BSA financial statutory scheme, and the SEC's claim that it can imbue

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Order at 6 [Dkt. 224]. Those statements strongly suggest that, while FinCEN itself has carefully differentiated between examination authority and enforcement authority, the district court did not.

[86] December Op., at 30-31 [Dkt. 174]; March Op., at 35-36 [Dkt. 101].

[87] December Op., at 30-31 [Dkt. 174].

[88] March Op., at 36-38 [Dkt. 101].

itself with that authority is baseless. *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649–650 (1990) ("[A]n agency may not bootstrap itself into an area in which it has no jurisdiction.").

More importantly, that precise authority is expressly vested elsewhere, and Section 17 does not and could not permit the SEC to invade authority *that was conferred by Congress to another agency in another statute. Brown & Williamson*, 529 U.S. at 125, 161 (*supra*). The lower court plainly erred by focusing on Section 17(a) in isolation and ignoring the subsequent and specific Congressional delegation of authority that governs the BSA. As the Supreme Court stated:

> [A] specific policy embodied in a later federal statute should control our construction of the [earlier] statute, even though it ha[s] not been expressly amended …This is particularly so where the scope of the earlier statute is broad but the subsequent statutes more specifically address the topic at hand.

Id. at 143.

In accordance with those settled principles, courts have consistently rejected attempts by agencies, including the SEC, to expand their own jurisdiction or invade other agencies' jurisdictions. *Am. Bankers Ass'n. v. S.E.C.*, 804 F.2d 739, 755 (D.C. Cir. 1986) ("[t]he SEC cannot use its definitional authority to expand its own jurisdiction and to invade the jurisdiction of other agencies"); *see also Bayou Lawn & Landscape Servs. v. Sec'y of Labor*, 713 F.3d 1080, 1084-85 (11th Cir. 2013) (where rulemaking authority was granted to the Department of Homeland Security ("DHS"), court rejected, as an "absurd reading of the statute,"

the Department of Labor's ("DOL") argument that because DHS was required to "consult" with DOL, that this "empowered [DOL] to engage in rulemaking, even *without* the DHS," because "it would be hard pressed to locate that power in one agency where it had been specifically and expressly delegated by Congress to a different agency" and because DOL "cannot bootstrap [a] supporting role into a co-equal one"); *California v. Klepp*, 604 F.2d 1187 (9th Cir. 1979) (holding Environmental Protection Agency could not exercise control of air quality in the outer continental shelf ("OCS") under the Clean Air Act because it conflicted with the delegation of authority to regulate air quality in the OCS to the Secretary of the Interior ("Interior Secretary") under the Outer Continental Shelf Lands Act).

As the Supreme Court has explained, a "specific authorization" to act trumps a "general authorization," particularly "'where Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.'" *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) (citation omitted); *see also U.S. v. Estate of Romani*, 523 U.S. 517, 532-34 (1998) (holding the government could not rely on the broadly applicable federal priority statute to circumvent the limitations imposed upon it by the later-enacted, more specific, Tax Lien Act).

This Court's decision in *Nutritional Health* illustrates the precise analysis that applies in this case and yet that decision was wholly disregarded – not even

acknowledged – by the lower court. There, this Court held that the FDA did not have authority to regulate "packaging" of drugs for "poison prevention purposes," despite the FDA's "broad authority" under the FDCA to regulate "food and drugs in order to protect public health." *Nutritional Health Alliance v. F.D.A.*, 318 F.3d 92, 95, 98 (2d Cir. 2003). To determine the scope of the FDA's authority, this Court observed that, under *Brown & Williamson* and similar authorities, it was required to consider not just the FDCA, but also later-enacted statutes that specifically targeted poison-prevention packaging and conferred regulatory authority on a different agency – the Consumer Product Safety Commission ("CPSC"). *Id.* at 94, 102-03. This Court expressly rejected the argument that it should defer to the FDA's position on the scope of its own authority and held that the subsequent specific delegation of authority to the CPSC precluded the exercise of authority by the FDA, stating that the FDA's claim of concurrent jurisdiction struck a "discordant tone" and would "circumvent the detailed regulatory scheme" put in place by Congress. *Id.* at 104.[89]

The reasoning of *Nutritional Health* and similar decisions is dispositive here. The BSA and its implementing regulations "specifically and unambiguously" cover the subject matter of SAR reporting and are part of a "regulatory structure

[89] "On that basis, this Court refused to give *Chevron* deference to the FDA's construction of the FDC Act." *See id.* at 102, 104.

created by Congress" to address money laundering and terrorist financing through the compilation of data derived from various financial institutions. That subsequent and specific authority precludes assertion of jurisdiction by the SEC.

These decisions are also driven by the policy considerations that underlie the specific conferral of authority by Congress, and the disruptive effect that would result from a unified regulatory scheme being subject to differing interpretations of various agencies, each with their own regulatory approaches and agendas. *Id.* at 104. That issue of conflicting interpretations and enforcement, and the potential for havoc and inequities, is vividly illustrated here. FinCEN must administer and interpret those provisions in ways that facilitate their application to a range of institutions including banking, casino, and money services businesses, and with the goal of encouraging collaboration with those businesses. To that end, it adopted clear and consistent approaches to enforcement, emphasizing that the filing of a SAR is a "judgment call" of a business, and that application of the SAR filing provisions is a product of a particular firm's knowledge, experience and market.[90] The SEC should not be permitted to upend that approach and rewrite the SAR rules to suit its particular purpose.

[90] *See* Alpine's Add'l SOF, ¶¶ 11-16 [Dkt. 88] and Alpine's SOF, at ¶¶ 3-9 [Dkt. 85] (listing consistent statements by FinCEN).

Inconsistent application also results from the SEC's insistence that Rule 17a-8 subsumed some – but not all – of the SAR provisions. The BSA consists not only of the currency and SAR reporting requirements but also its own enforcement and penalty provisions, 31 U.S.C. § 5321. Congress established penalties in the BSA that are much lower than those under the Exchange Act and it did *not* impose the strict liability that exists under the recordkeeping provisions of the Exchange Act. *Compare* 31 U.S.C. § 5321 *with* 15 U.S.C. § 78u(d)(3). Yet the SEC insists it can slice and dice those BSA provisions, appropriating only the SAR filing provisions while ignoring the remedial scheme Congress specifically created for the BSA. The SEC maintains that for precisely the same conduct, a broker-dealer faces a different standard of proof and penalties that are exponentially higher than firms in other financial sectors. Such an assertion is plainly impermissible: it contravenes the enforcement scheme Congress put in place in the BSA, and strips from FinCEN the essential ability to administer, interpret and enforce the BSA provisions in the manner directed by Congress. *See Nutritional Health, supra; RadLAX, supra.*[91] Indeed, such a position creates an irreconcilable anomaly: if the SEC had actually been delegated authority to enforce Section 1023.320 directly, it

[91] *See also Loving v. I.R.S.*, 917 F. Supp. 2d 67, 75–77 (D.D.C. 2013), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014) (rejecting IRS's contention that it could regulate and penalize tax-return preparers under its general authority to regulate the practice of representatives pursuant 31 U.S.C. § 330 because, *inter alia*, "statutes scattered across Title 26 of the U.S. Code create a careful, regimented schedule of penalties for misdeeds of tax return preparers," that would be "eclipsed" by the IRS's interpretation of § 330).

would undoubtedly be circumscribed by the limits of Section 5321; it cannot skirt those limits through indirect *ultra vires* enforcement of that same regulation under the Exchange Act. Congress, in fact, has stated that agencies cannot rely on general penalty authority to circumvent the penalty structure of Section 5321, *specifically*.[92]

The law, legislative history and policy pertaining to Congress' decision to delegate authority for administration of the BSA in the Department of Treasury are clear and consistent. On the other hand, *no* authority supports the district court's facile assumption that the Exchange Act's grant of authority to the SEC in relation to the making and maintenance of "reports" empowers the SEC to usurp the authority of another agency. The district court never addressed and did not apply the relevant decisions and its ruling should be reversed.

[92] *See* 135 Cong. Rec. S2379-02, 135 Cong. Rec. S2379-02, S2393, 1989 WL 171463 (stating that, although Congress passed 12 U.S.C. § 1818(i)(4) to give federal banking institutions "general civil penalty authority" for violations "of any law or regulation relating to financial institutions," the "use of this [general] authority . . . would not be appropriate if there was a civil penalty authority under a more specific penalty statute such as 31 U.S.C. 5321.").

POINT II
RULE 17A-8 DOES NOT PROVIDE A VALID BASIS FOR THE SEC TO PURSUE AN ACTION FOR PURPORTED VIOLATIONS OF THE SAR PROVISIONS OF THE BSA

Even *if* the SEC could, under Section 17(a), confer on itself enforcement authority to pursue violations of the BSA, it has never properly promulgated any rule that would enable it to do so. Instead, for purposes of this case, it cobbled together a theory that its *1981* issuance of Rule 17a-8 was somehow able to "evolve over time" to "dynamically" incorporate FinCEN's later-promulgated SAR regulations, without the SEC having to bother to comply with the notice, comment and publication requirements of the APA or the FRA. The district court erred in accepting, and giving *Auer* deference to, the SEC's argument.

A. The SEC's Interpretation of Rule 17a-8 Violates the APA, the Federal Register, and the Nondelegation Doctrine

Rule 17a-8 was originally passed in 1981 when the BSA had no SAR reporting requirements.[93] It included only *currency* reporting provisions, and the SEC promulgated Rule 17a-8 to address specified "recordkeeping and retention requirements" in relation to the Currency Act. 46 Fed. Reg. 61,454, 61,455 (1981) (emphasis added). The SEC's notice of publication set out the *specific* reports that were the subject of the proposed rule, *i.e.*, reports of currency transactions and

[93] The Treasury Department did not promulgate the SAR provisions until eleven years later, in 1992, and they were not made applicable to broker-dealers until 2002. *See* 67 Fed. Reg. 44,048, 44,048-049, 44,057 (July 1, 2002).

transactions involving foreign accounts that existed at the time. *Id.* at 61,455.

The SEC's notice also confirmed that Treasury retained authority over the administration of the Currency Act and acknowledged that the SEC's role in relation to the BSA was limited to *examination* authority. *Id.* at 61, 454.

Notwithstanding the clear purpose and scope of Rule 17a-8, the SEC argued in this case that the rule, like a regulatory sponge, managed to absorb *ad infinitum* any and all provisions of the BSA, whenever enacted. According to the SEC, "there was no need for the Commission to revisit Rule 17a-8 to extend its reach to broker-dealer SAR obligations," or engage in any notice and comment, because the rule "allow[ed] for any revisions the Treasury may adopt in the future."[94] It had avoided any need for future compliance with the APA, the SEC insisted; the rule automatically subsumed the SAR reporting requirements without the SEC even notifying the industry of that rather substantial development.

The district court improperly deferred to that argument, agreeing that Rule 17-8 could "evolve over time" without any need for the SEC to comply with the APA.[95] March Op., at 38 [Dkt. 101]. The plain error of that ruling is illustrated by the decision in *United States v. Piccoitto*, 875 F.2d 345 (D.C. Cir. 1988), in which

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[94] SEC's Opp. to Alpine's Cross-Motion for Summary Judgment, at 11 [Dkt. 92].

[95] "Deference" to an agency, under either *Chevron* or *Auer*, "is not warranted where the regulation is 'procedurally defective' – that is, where the agency errs by failing to follow the correct procedures in issuing the regulation." *Encino Motorcars, LLC v. Navarro,* 136 S.Ct. 2117, 2125 (2016).

the D.C. Circuit Court rejected the Park Service's argument that because its original regulation "went through notice and comment, the new restrictions [purportedly imposed under that regulation] do not need to." *Id.* at 346.

> In essence, the Park Service is claiming that an agency can grant itself a valid exemption to the APA for all future regulations, and be free of APA's troublesome rulemaking procedures forever after, simply by announcing its independence in a general rule. ***That is not the law***. Such agency-generated exemptions would frustrate Congress' underlying policy in enacting the APA by rendering compliance optional. The statute's direct mandate requires notice and comment procedures for any rule that does not fall within certain express exceptions. See § 553(b)–(e).

Id. at 346-47 (emphasis added); *see also City of Idaho Falls v. F.E.R.C.*, 629 F.3d 222, 227-29 (D.C. Cir 2011) (holding FERC violated APA by attempting to adopt, without additional notice and comment, updated Forest Service fee schedules, after a previous version of fee schedule was incorporated by reference in FERC's regulations). As the Court held in *City of Idaho Falls:*

> Because FERC previously approved and used the old Forest Service methodology, its implicit acceptance of the new methodology in the 2009 Update *marked a change in its own regulations. For FERC to make such a change, APA section 553 required notice-and-comment rulemaking.*

629 F.3d at 230 (emphasis added). Those decisions establish that the SEC could not "incorporate" not-yet-extant legislation, and confer on itself authority to enforce a future statutory scheme, without complying with the APA.

The district court also disregarded yet another problem with the SEC's

theory of dynamic incorporation: permitting absorption of other not yet existing statutes promulgated by a different agency would constitute an improper delegation of rulemaking authority under the Exchange Act. *See* 15 U.S.C. 78q(a)(1) (requiring broker-dealers to "make and disseminate such reports as *the Commission, by rule*, prescribes . . . ." (emphasis added)). If the requirements of Rule 17a-8 automatically change every time FinCEN amends its BSA regulations, then it is FinCEN, not the SEC, that is engaging in rulemaking under Section 17(a). *City of Idaho Falls*, 629 F.3d at 229-30 (describing this violation of the non-delegation doctrine as a "second fatal defect" to FERC's use of updated Forest Service fee schedules).

Further, specifc regulations promulgated to implement the APA and FRA preclude an agency from *dynamically* incorporating another agency's presently *nonexistent* regulations, such that a rule would "evolve over time." March Op., at 38 [Dkt. 101]. The regulations of the Office of the Federal Register ("OFR"), *which are controlling authority on incorporation by reference under the APA*, 1 C.F.R. 51.1(a)-(c), require agencies to, *inter alia*, obtain formal approval to incorporate any materials by reference. 1 C.F.R. § 51.5(b). And the OFR regulations expressly state that "incorporation by reference of a publication is limited to the edition of the publication that is approved. *Future amendments or revisions of the publication are not included*." 1 C.F.R. § 51.1(f) (emphasis

added). *See also* Emily S. Bremer, *Incorporation by Reference in an Open-Government Age*, 36 Harv. J.L. & Pub. Pol'y 131, 183–86 (2013) (citing authorities that prohibit dynamic incorporation including the APA, the OFR regulations, and the constitutional "nondelegation doctrine").

As with the issue of jurisdiction, the SEC's expansive and elastic view of Rule 17a-8 was unprecedented, and the law makes clear the invalidity of its attempts to circumvent the APA and ignore the provisions of the Federal Register Act, but that law was never addressed by the district court. The decision of the district court should be reversed on this separate ground also.

B. The District Court Improperly Applied *Auer* Deference and Failed to Consider and Apply the Decision in *Kisor v. Wilkie*

In acceding to the SEC's invalid interpretation of Rule 17a-8, the district court applied *Auer* deference in a manner that contravenes *Kisor's* specific holdings. Both the majority and the concurrences in *Kisor* made clear that the Supreme Court "remodeled" and "revised" the concept of *Auer* deference to "cabin[] its scope in varied and critical ways" and to ensure that courts would no longer "afford *Auer* deference mechanically." *See Kisor,* 139 S.Ct. at 2414-15, 2425, 2447-48. While *Kisor* did not expressly overrule Auer deference, it unquestionably limited it in significant ways that are directly applicable to the district court's decisions. *See, e.g., Altera Corp. & Subsidiaries v. I.R.S.,* 941 F.3d 1200, 1210 (9th Cir. 2019) (recognizing "the very detailed limitations on *Auer*

deference spelled out in *Kisor*").

In two critical respects, the district court committed the precise errors that were discussed in *Kisor*. First, the lower court failed to "empty[] the legal toolkit" of statutory construction before applying agency deference. By employing *Auer* deference, without first applying the settled principles of law discussed above that should have governed the interpretation of Section 17 and Rule 17a-8, the district court improperly "jumped the gun."

Second, the lower court deferred to assertions not worthy of or appropriate for deference. *Kisor*, 139 S.Ct. at 2415, 2423-24. *Kisor* confirmed that only certain deliberative pronouncements of the agency that possesses expertise are "entitle[d] . . . to controlling weight." 139 S.Ct. at 2416. The SEC's claims regarding Rule 17a-8 do not satisfy those requisites: there is no indication that the positions taken by the SEC's Division of Enforcement in litigation are any more than "convenient litigating positions," as opposed to the Commission's "fair and considered judgment," nor does it possess the relevant expertise. *Id.* at 2416-17. Perhaps more importantly, because the SEC's interpretation of Rule 17a-8 would impinge upon another agency's authority, the SEC's view is not entitled to deference. As observed in *Kisor*, "the basis for deference ebbs when '[t]he subject matter of the [dispute is] distan[t] from the agency's ordinary' duties or *'fall[s] within the scope of another agency's authority.*" *Id.* at 2417 (alterations in original)

(emphasis added).

Here, the district court failed to address or even acknowledge the critical teachings of *Kisor*, it failed to apply established principles of statutory construction and incorporation by reference, it deferred to agency assertions that were neither authoritative nor propounded by the correct agency, *and* it turned a blind eye to the pronouncements of FinCEN concerning its retention of exclusive enforcement authority and the proper approach to enforcement.

The district court's second basis for concluding that "the SEC may bring this action under Rule 17a-8" was also defective. The district court held that the SEC had "announced" its interpretation of Rule 17a-8 as encompassing the duty to file a SAR and otherwise comply with Section 1023.320 in a formal adjudication in the *Bloomfield* litigation – *twelve years after* SAR provisions became applicable to broker dealers.[96] Contrary to the court's assertion, however, the *Bloomfield* decision in 2014 would not have served as a valid way for the SEC to "announce" that Rule 17a-8 incorporated the SAR provisions of the BSA. *Id.* Not only was the SEC's authority to enforce the SAR requirements not litigated in the *Bloomfield* matter, *see* 2014 WL 768828, but the premise of the court's analysis ran afoul of a specific holding in *Kisor*:

[96] December Op., at 31-32, n.34 [Dkt. 174] (citing *In re Bloomfield*, SEC Release No. 9553, 2014 WL 768828 (February 14, 2014)); *see also* March Op. 39-40 [Dkt. 101].

> The premise on which [this argument] proceed[s]—that the APA permits agencies to issue "controlling" amendments to their regulations in adjudicative proceedings—is not correct. Once an agency issues a substantive rule through notice and comment, it can amend that rule only by following the same notice-and-comment procedures.

Kisor, 139 S. Ct. at 2435 (J. Gorsuch concurring) (citing *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, at 1206 (2015) (APA "mandate[s] that agencies use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance.").

POINT III
THE DISTRICT COURT ERRED IN CREATING HARD AND FAST "RED FLAG" RULES RELATING BOTH TO THE SAR FILING REQUIREMENT AND THE CONTENT OF THE SAR NARRATIVE

The district court proved the havoc wreaked when one agency usurps the province delegated to another agency, when it turned to the merits of the SEC's claims regarding SAR filing and content requirements. The district court accepted the SEC's invitation to use snippets from a few pieces of industry guidance to devise, through a series of unprecedented rulings, new definitions of BSA violations, predicated on simplistic and generic characteristics: a large deposit of a low-priced security plus a "red flag."[97] Specifically, the SEC argued, and the

[97] The red flags the SEC pulled from guidance for *this case* are: (1) criminal or regulatory history or other "related litigation"; (2) shell company involvement or other derogatory history of the stock; (3) stock promotion; (4) an unverified issuer; (5) low trading volume; and (6) foreign involvement. *See* December Op., at 2 [Dkt. 174]. However, there are dozens of red flags listed in guidance that the SEC could substitute in a future case.

district court held, that these circumstances alone constitute an "objective" "reason to suspect" that the transaction involved criminal conduct and required a SAR filing as a matter of law, and that any SAR that did not mechanically discuss the red flag was deficient as a matter of law.[98] These rulings are unsupported, untenable and plainly at odds with FinCEN's avowed approach to BSA enforcement.

A. The Actual SAR Filing and Narrative Requirements

1. "Reason to Suspect" Criminal Activity

The starting point of any SAR analysis is the determination of whether a SAR filing is required. The BSA provides, in pertinent part, that a SAR filing is mandatory if a transaction or pattern of transactions exceeds $5,000.00 and the broker-dealer "knows, suspects or has reason to suspect" that it is being used *to facilitate criminal activity*. 31 C.F.R. § 1023.320.

FinCEN has consistently defined the SAR analysis as a "subjective determination" by a firm predicated on all of the "facts and circumstances" relating to its business and a particular transaction. FinCEN's view of the SAR filing requirement was plainly stated in FinCEN's notice of the broker-dealer SAR Rule:

> A determination as to whether a report is required *must be based on all the facts and circumstances relating to the transaction and customer* of the broker-dealer in question. Different fact patterns will

[98] *See* March Op. at 59 [Dkt. 101]; December Op. at 48-49, 51-52 [Dkt. 174].

> require different types of judgments . . . . [including] whether the facts and circumstances and the institution's *knowledge of its customer provide a reasonable explanation for the transaction that removes it from the suspicious category*.

See 66 Fed. Reg. 67,670, 67,673 (Dec. 31, 2001) (emphasis added).

FinCEN's own definition of the "reason to suspect" standard expressly states that the language does *not* obviate a subjective analysis:

> The reason-to-suspect standard means that, on the facts existing at the time, a reasonable broker-dealer in similar circumstances would have suspected that the transaction was subject to SAR reporting. *This is a flexible standard that adequately takes into account the differences in operating realities among various types of broker-dealers . . . .*

See 67 Fed. Reg. 44,048, 44,053 (July 1, 2002) (emphasis added). This definition preserves the subjectivity inherent in the SAR-filing decision by simply shifting the focus to whether a hypothetical similarly-situated "reasonable" broker-dealer, faced with its own "operating realities," would conclude that the transaction was indicative of criminal activity and therefore subject to reporting. *See* Alpine's Expert Rebuttal Report, ¶¶ 155-168 [Dkt. 137].

The "facts and circumstances" analysis of reasonable suspicion is consistent with definitions of "reasonable suspicion" in other contexts. Our courts have long since established that "reasonable suspicion" does not include rank speculation or a generalized notion that there is something sketchy about a transaction or an individual. "Reasonable suspicion requires more than 'an inchoate suspicion or a mere hunch.'" *Dancy v. McGinley*, 843 F.3d 93, 106 (2d Cir. 2016) (citation

omitted). "It demands 'specific and articulable facts which, taken together with rational inferences from those facts,' provide . . . a 'particularized and objective basis for suspecting legal wrongdoing.'" *Id.* (citations omitted). The question of whether reasonable suspicion exists "can only be answered by considering the totality of the circumstances" viewed from the perspective of the one making the determination. *United States v. Hassanshahi*, 75 F. Supp. 3d 101, 123 (D.C. Cir. 2014). It does not allow for decisions based on pure bias or stereotypes concerning individuals or jurisdictions. And it does not require or even permit the assumption that one who is the subject of a pending claim, has entered into a settlement of a claim, or even has engaged in wrongdoing in the past, will repeat that conduct.[99]

Over the decades since the SAR regulations were promulgated, FinCEN directors and the Federal Financial Institutions Examination Counsel ("FFIEC")[100] have repeatedly underscored this essential aspect of the SAR analysis: a SAR filing decision is an inherently "subjective determination" and a "judgment call" by a

[99] *Hassanshahi*, 75 F. Supp. 3d at 120 ("Federal circuit courts have consistently held, however, that a person's criminal history is insufficient to create reasonable suspicion by itself."); *United States v. Walden*, 146 F.3d 487, 490 (7th Cir. 1998) ("Reasonable suspicion of criminal activity cannot be based solely on a person's prior criminal record.").

[100] The FFIEC was "established by Congress" and "'charged with establish[ing] uniform principles and standards . . . for examination of financial institutions'" for BSA compliance. *See Casissa v. First Republic Bank*, No. C 09-4129 CW, 2012 WL 3020193, at *9 (N.D. Cal. July 24, 2012) (citation omitted). In the *Sterne Agee* decision, the hearing panel described the FFIEC examination manual as the "applicable legal standard[]." *In re Sterne, Agee & Leach, Inc.*, No. E052005007501, at 32 (Mar. 5, 2010).

firm predicated on all of the "facts and circumstances" relating to its line of business and to a particular transaction.

- William J. Fox, Director of FinCEN, stated that "suspicious activity reporting, requires financial institutions to make judgment calls," and that "[c]ompliance should not be about second guessing individual judgment calls on whether a particular transaction is suspicious." Alpine Add'l SOF, at ¶ 13 [Dkt. 88].

- William F. Bailey, Deputy Director of FinCEN, stated that "[f]inancial institutions file Suspicious Activity Reports (SARS) after a subjective review of many variables." *Id.* ¶ 16.

- The FFIEC examination manual states that the "decision to file a SAR is an inherently subjective judgment, and thus "examiners should focus on whether the [financial institution] has an effective SAR decision-making process, not [on] individual SAR decisions." *Id.* ¶ 11.

FinCEN's statement in the Federal Register, comparing the subjectivity in the SAR process to the objectivity in Currency Transaction Reports ("CTRs"), is directly on point:

> [T]he CTR, which captures information based on objective facts that determine its filing, and the SAR, *which requires a financial institution to make a subjective determination of what is suspicious* prior to its filing, are complementary sources of information for law enforcement.

73 Fed. Reg. 74,010, 74,011 (December 5, 2008) (emphasis added).

That same subjective approach governs the content of the SAR narrative. FinCEN has been clear that a broker-dealer should, in the SAR narrative, explain

why the filer viewed the transaction as irregular and suspicious.[101] As expressly stated in the SAR Forms, "[f]ilers" are required to "provide a clear, complete, and concise description of ***the activity***," i.e., the transaction that is being reported, and "includ[e] what was unusual or irregular that ***caused suspicion.***" *See* 2012 SAR Form, at p. 110, Ex. 9 to SEC's SOF [Dkt. 75] (emphasis added); *see also* 2002 SAR Form, at Part IV(a), Ex. 8 to SEC's SOF [Dkt. 75] (providing similar instructions to "[d]escribe conduct that raised suspicion"). The instructions indicate further that information provided elsewhere in the SAR need not be repeated. *Id*. To assist filers, the instructions also include a "checklist" of items which "[f]ilers *should* use … as a *guide* for prepaing the narratives." *Id.*

2. "Red Flags" Are Items that Warrant Further Scrutiny – *Not* SAR Filing or Content Requirements.

Equally plain is that neither the SAR filing decision nor its content turns on the presence of a "red flag." All relevant guidance makes clear that "red flags" are issues that should be considered by the firm during the course of its analysis but are not themselves evidence of criminal activity.

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[101] In its examination manual, FFIEC states: "[b]y their nature, *SAR narratives are subjective*, and examiners generally should not criticize the [financial institution's] interpretation of the facts." *See* FFIEC Manual, Suspicious Activity Reporting – Overview (emphasis added), *supra*. Even the 2003 SAR narrative guidance issued by FinCEN, and relied upon by the district court, makes the subjectivity clear by indicating that the "why" in the narrative means "why does *the filer* think the activity is suspicious." *See Guidance on Preparing a Complete & Sufficient Suspicious Activity Narrative* (2003), at 4, Ex. 1 (emphasis added) [Dkt. 75] [Dkt. 154].

- The FFIEC stated: "The following examples are red flags that, when encountered, **may** warrant additional scrutiny. The mere presence of a red flag is not by itself evidence of criminal activity. Closer scrutiny should help to determine whether the activity is suspicious or one for which there does not appear to be a reasonable business or legal purpose." *See* Alpine's Response to SEC's SOF No. 27, at 28, n.7 [Dkt. 154].[102]

- FinCEN stated: "The presence or absence of a red flag in any given transaction is not by itself determinative of whether a transaction is suspicious." *Id*. at n.8 [Dkt. 154].[103]

The SEC's own examiner, OCIE, has also plainly confirmed that the SAR analysis does not hinge on any particular flag. In a Risk Alert that discusses "examples" of "potentially unusual or suspicious activity in connection with customers' sales of microcap securities," OCIE emphasized:

> The Staff does not contend that the existence of any of these examples, which may indicate suspicious activity, necessarily triggers the broker-dealer's obligation to file a SAR. Whether the broker-dealer has such an obligation depends on *the totality of facts and circumstances in a particular situation*. *Id*. at n.9 [Dkt. 154].[104]

The only definitive adjudication of the "red flag" theory occurred in *In re Sterne Agee*, No. E052005007501 (March 5, 2010), and the Hearing Panel there specifically held that reflexive rules do *not* exist. In that proceeding, regulators pursued precisely the same mechanical "red flag" approach advocated here by the

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[102] Alpine's Response to SEC's SOF No. 27 [Dkt. 154].

[103] Fin-2017-A007, at 4 (Oct 31 2017) Advisory to Financial Institutions Regarding Disaster – Related Fraud, available at https://www.fincen.gov/resources/advisories/fincen-advisory-fin-2017-a007-0

[104] OCIE, Risk Alert: *Broker-Dealer Controls Regarding Customer Sales of Microcap Securities*, at 5 n.17 (October 9, 2014) (emphasis added), available at https://www.sec.gov/about/offices/ocie/broker-dealer-controls-microcap-securities.pdf

SEC, and adopted by this district court. Those red flag arguments were soundly *rejected* in favor of the analytical approach laid out by FinCEN. In its decision, the panel emphasized the "importance of focusing on the process," rather than on individual SAR decisions, and held that the respondent acted reasonably by *not even filing* a SAR. *Id*. at 31-32.

Notably, the circumstances in *Sterne Agree* were very similar to this case: a clearing firm was accused of improperly failing to file SARs where there were offshore entities that were depositing and selling large quantities of low-priced securities and then wiring the proceeds, often with the presence of "other red flag" circumstances including evidence of a customer's disciplinary history, involvement of foreign jurisdictions, and the wiring of proceeds offshore. *Id*. at 14, 18, 21, 32. Those red flags, the panel concluded, were items that warranted further review, and they were in fact reviewed by the "AML compliance officer [who] looked into the activity, and concluded that there was a reasonable business explanation for all of it . . . ." *Id*. at 33. Those investments were determined to be part of the customer's regular activity of private investment in public equity ("PIPE"), and so the firm's failure to file a SAR did not violate the BSA. *Id*. As the *Sterne Agee* decision makes clear, presented even with an accumulation of purported red flags, a firm is permitted to make decisions not to file SARs or reference the "red flag" activity

where there are reasonable business explanations for the transactions. *Id.* at 32-33.

Significantly, the SEC's expert witness in this case confirmed that she was instrumental in formulating the red flag approach used in *Sterne,* and she acknowledged the Panel's repudiation of that approach. [105] She also confirmed that the expert witness for the defense in *Sterne Agee* – Peter Djinis, the principal author of the SAR BD rules[106] – offered a decidedly different view of the correct approach to the allegation of failures to file SARs. In testimony that was accepted and credited by the hearing panel in *Sterne Agee,* he explained that the issue of whether a firm complied with the BSA required an evaluation of its process, not just its SAR filing decisions. *Sterne Agee,* at 31-32.

Rather than accepting the decision of that panel in *Sterne Agee*, however, the SEC's witness has continued since then, even in this case, to advocate her own view, deeming the *Sterne* decision "wrong." [107] She does not dispute the panel's conclusion that the firm's filing decisions were reasonable; she just feels that her view is "more" reasonable: "I think reasonable people can disagree over – over

[105] Angotti Dep., at 57:10-67:21, Ex. 10.
[106] *See* 67 Fed. Reg. at 44,048.
[107] Angotti Dep., at 70:14-71:13, 75:1-18, Ex. 10.

whether that is reportable, and I think it is more reasonable to say that you should file." [108]

B. The District Court Erred in Creating Automatic Red Flag Requirements

Notwithstanding the extensive and consistent authority concerning SAR filing requirements, the SEC in this case argued that a purely mechanical test applied to a firm's obligation to file a SAR and the content of the narrative. In endorsing the SEC's "red flag" theory, the district court relied on a patchwork of a few selected "red flags" in four pieces of informal guidance,[109] language contained in the instructions to the SAR Forms, and a litigated regulatory matter that was not even decided until after the period at issue in the complaint (March Op., at 42-65 [Dkt. 101].) Using these bits and pieces of guidance, the district court followed the SEC's lead to fashion broadly applicable bright-line SAR filing and content rules. To determine whether a SAR needed to be filed, the district court adopted the "SEC's proposed test," based on a strained application of the "reason to suspect" language of Section 1023.320(a), that a transaction is *objectively* suspicious of a crime if it involves a large deposit of low-priced securities and mention of one

[108] *Id.* at 72:16-73:9, Ex. 10.

[109] The informal FinCEN guidance cited by the Court consists of (1) *Guidance on Preparing a Complete & Sufficient Suspicious Activity Narrative* (2003) (Ex. 1 [Dkt. 75])) (2) *SAR Activity Review, Trends Tips & Issues #22* (October 2012) (Ex. 2 [Dkt. 75]); (3) *SAR Activity Review, Trends Tips & Issues # 15* (May 2009) (Ex. 3 [Dkt. 75]); and (4) FIN-2006-G014, Potential Money Laundering Risks Related to Shell Companies (Nov. 9, 2006) (Ex. 23 [Dkt. 75]).).

other "red flag" the SEC had culled from guidance. December Op., at 47-48 [Dkt. 174]. In adopting this rule wholesale, the court effectively ignored the issue of whether the conduct was indicative of any actual crime. The SEC never even claimed, much less proved, that any conduct associated with any Alpine transaction involved any criminal activity, and it referred to the component of "criminal activity" only in the most generic and vague terms, claiming that the presence of a "red flag" would indicate "market manipulation," a "pump and dump scheme," a "sale of unregistered securities" or just general "fraud."[110] Neither the SEC nor the court identified which transactions were suspicious of which type of criminal conduct, or how any of the red flags signaled commission of crimes in any of the transactions at issue.[111]

In addition to establishing a new SAR filing trigger, the district court also adopted the second component of the SEC's claim, *i.e.*, that the same rigid rules govern what must be contained in the narrative portion of the SAR, and failure to include that information constitutes a violation of the BSA, just as if no SAR had been filed. In the process, the district court turned FinCEN's guidance upside down, holding that it is the presence of red flags, *not* the firm's reasons for the filing of the SAR, that determine the content of the narrative.

[110] *See* SEC Mem. in Supp. of Summ. Jd. on Liability, at 10-11 [Dkt. 147].
[111] *See id.*

1. The Court Misinterpreted the Guidance and SAR Forms

In formulating the red flag rules in this case, the district court relied on checklists in the SAR Form instructions, but those Forms do not impose any mandatory SAR narrative requirements. Rather, the Form instructions expressly use permissive language, stating that filers "should use the . . . checklist as a guide" for preparing the SAR narrative.[112] FinCEN knows how to impose mandatory requirements, and its failure to use words like "shall" or "must," identifies this checklist as hortatory rather than obligatory. The only narrative *requirement* is that the filer describe "why" the transaction caused *the filer* to conclude the transaction fell within one of the four categories of the regulation. This interpretation, unlike the one advocated by the SEC and adopted by the district court, is consistent with guidance.

Nor do the SAR Form Instructions align with the "red flag" rules the district court created. The Forms do not list issues such as the involvement of a shell, promotional history, low trading volume, or any "foreign involvement." *See* SAR B-D Form, Ex. 71 to Alpine's Add'l SOF [Dkt. 154]. The only SAR Form item that even roughly corresponds to those cited by the SEC is the Form's reference to "related litigation." And that reference does not support the district court's ruling that a required "red flag" includes any litigation, including private civil litigation,

[112] Alpine's Add'l SOF, at ¶¶ 160-161 [Dkt. 154] (citing the SAR Form instructions).

having nothing to do with the reported transaction, against *anyone* associated with the transaction. December Op., at 55-56 [Dkt. 174]. Certainly, it is reasonable that Alpine would interpret this ambiguous term more narrowly, and include references to litigation only if it related *to the transaction* or was otherwise material to the reason the SAR was filed.

The court also mischaracterized the SAR Form to create a red flag for "foreign involvement." The SAR Form refers to foreign *currency*, and it seeks certain identifying information if the SAR is being filed in relation to a "foreign national."[113] But the court viewed these references to the term "foreign" to require the narrative to report any mention of a foreign country or person in the support file, even where the transaction being reported did not involve foreign currency or foreign nationals. December Op., at 83-86 [Dkt. 174]. The district court's ruling that "foreign" involvement had to be discussed in the narrative was also directly contrary to the Form instructions which state that information provided in "earlier parts of the form need not necessarily be repeated if the meaning is clear."[114] Here, the district court found violations of the BSA even where the subject of the

[113] *See* 2002 SAR B-D Form, at 3, ¶¶ L, O, P and Q, Ex. 71 to Alpine's Add'l SOF [Dkt. 154].
[114] SAR B-D Form, at 3, Ex. 71 to Alpine's Add'l SOF [Dkt. 154].

SAR was a foreign person or entity *and* that foreign jurisdiction was described in the first section of the SAR Form regarding the "subject" of the SAR.[115]

The district court's treatment of other red flag categories, including its reformulation of rules espoused by the SEC, also confirms these supposed red flags rules do not exist, do not make sense, and were being constructed on-the-fly. By way of example, the SEC maintained that if the issuer had *ever* been a shell company, that was a "red flag" and a SAR requirement, even though FinCEN had issued guidance stating that "most shell companies are created to serve legitimate business purposes."[116] Alpine's evidence confirmed its employees reviewed shell company status, identified "green flags" which established that the issue was not "suspicious," and so did not include it in the narrative.[117] The court disregarded that evidence and devised its own rule, nowhere previously espoused, that issuer shell status was a "red flag" that required automatic SAR reporting if the issuer were a shell *within the prior year*, regardless of any other circumstances.[118]

Similarly, the SEC argued that evidence of any stock promotion at any time was a "red flag" that required SAR reporting and discussion in the narrative, citing as its support an SEC administrative decision reporting a settlement published ***after***

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[115] *See* Alpine's Add'l SOF, ¶ 215(a)-(d) [Dkt. 154].
[116] *See* Alpine's Add'l SOF, ¶ 189(d) and 190 [Dkt. 154] (citing FinCEN guidance FIN-2006-G014, at 1, 4).
[117] Alpine's Add'l SOF, ¶¶ 193, 197-198 [Dkt. 154].
[118] March Op., at 50-53 [Dkt. 101] and December Op., at 67-71 [Dkt. 174].

the conduct at issue in this case – *In re Albert Fried & Co.*, SEC Release No. 7791, 2016 WL 3072175 (June 1, 2016). That settled matter stated only that evidence of an "ongoing" stock promotion was a red flag, which together with other red flags, was indicative of suspicious conduct for SAR reporting. *See id.* at *5. Alpine demonstrated its employees did consider evidence of stock promotion, and included it in the narrative where the promotion occurred within 30 days but not if it was historical.[119] The district court rejected the SEC's version of the rule, and Alpine's evidence, and held that stock promotion *within the prior six months* must be discussed in the narrative as a matter of law.[120] Notably, in formulating this bright-line rule, the district court made no allowance for the fact that stock promotion is expressly permitted by section 17(b) of the Securities Act, provided disclosures of compensation are made. 15 U.S.C. § 77q(b).

The machinations relating to the purported "low trading volume" flag also vividly illustrate this point.[121] The SEC claimed that "low trading volume" is a SAR requirement where the deposit is at least three times the average daily trading volume of the stock. But low trading volume is an inherent characteristic of most

[119] Alpine's Add'l SOF, at ¶¶ 200, 202-203 [Dkt. 154].
[120] December Op., at 72 [Dkt. 174].
[121] The only guidance cited to support this category as a "red flag" is ambiguous and appears simply to be describing the characteristics of a microcap stock. March Op., at 58 [Dkt. 101] (citing SAR Activity Review, Issue 15 at 24 that "a substantial deposit, transfer or journal of very low-priced and thinly traded securities" as the sole support for low trading volume being a red flag that must be reported).

microcap stocks, and so defining it as a SAR requirement would apply to virtually every such transaction. Even the district court disagreed with the SEC's version of the rule, and crafted a new one, holding that low trading volume is an automatic SAR trigger only where the deposit is *twenty times* the average daily trading volume. December Op. at 80-81 [Dkt. 174]. The district court cited no basis for the 20x rule and there is none; both the SEC and the court were inventing them. *Id.* at 82. To hold that Alpine violated the SAR regulation as a matter of law by failing to discuss this evolving supposed red flag is both baseless and violative of basic principles of fair notice.

The irrationality of the SEC's position is further illustrated by its allegation regarding SAR No. 511: that narrative, consisting of over 500 words, detailed a number of circumstances that Alpine found suspicious. Alpine's Add'l SOF ¶ 211(g) [Dkt. 154].). Confronted with this SAR during her deposition, even the SEC's expert conceded that she would *not* have charged it just because it omitted low trading volume. Angotti Dep., at 364:13-20, Ex. 10 to Alpine's Add'l SOF [Dkt. 154]. The SEC then removed this SAR, without explanation, *after* it sought summary judgment on it.

And that is not an isolated example. There were hundreds of other instances in which the SEC originally claimed that a particular SAR violated the BSA, but that SAR was excised by its own expert because she could find nothing wrong with

the narrative, or the court's reformulation of the rule took it outside of summary judgment. *Id.* at 136:8-15; 227:11-18, Ex. 10. In the end, roughly *one quarter* of the 2,013 SARs originally included by the SEC in its Table A as violations were removed by the SEC's own expert, again highlighting that "reasonable people can disagree."

2. The Automatic Red Flag Requirements Created by the District Court Are Arbitrary and Irrational.

The red flag requirements advocated by the SEC and adopted by the court are neither logical nor workable. There are innumerable red flags scattered throughout dozens of various guidance documents, and they are continually evolving.[122] The necessary consequence of the court's ruling is to impose a SAR narrative requirement not just for the categories selected by the SEC here but for each and every one of the dozens of red flags listed in the guidance – and even ones not identified in guidance. It is both unduly burdensome to the industry, and counterproductive to law enforcement, to require every financial institution to mechanically list all of the potential "flags" that are uncovered or referenced in a file, even if completely irrelevant to the transaction, in every single SAR filed.[123]

Such arbitrary and objective "rules" cannot and should not be sustained. Not

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[122] FinCEN, "SAR Activity Review – Trends, Tips & Issues," Issue 15, Ex. 202 to Alpine's Add'l SOF [Dkt. 154], at 24 (1 red flag); FinCEN, "SAR Activity Review – Trends, Tips & Issues, Issue 22 Ex. 2 to SEC's SOF [Dkt. 148], at 22-23 (13 red flags); FFIEC Manual at Appendix F-1 to F-10 (129 red flags), *supra*.

[123] Alpine's Expert Report, at ¶¶ 198-200 [Dkt. 137].

every transaction involving a large quantity of microcap stock must be viewed as objectively suspicious of a crime simply because, for example, there was a reference to some litigation, including private civil actions, involving someone connected in some way to the transaction. Similarly, a large transaction in microcap stock does not become "objectively" indicative of criminal activity solely because there was some promotion of the stock in the prior six months; because a foreign individual or entity was involved somewhere in the transaction; because a website could not be verified; because the issuer was a shell company within one year prior to the transaction; because the stock was thinly traded at the time of the deposit, or because there was a sale of the stock shortly after the deposit – an occurrence that both Alpine's fact witnesses and expert testified was common in the OTC market.[124] Yet, this is precisely the objective standard the district court adopted, contrary to all regulatory guidance that existed at the time.

C. The District Court Erred in its Deference to the SEC's Theories

In fashioning the red flag rules for SAR narrative content, the district court concluded that, given "the breadth of Section 1023.320," FinCEN guidance "is entitled to deference and is binding so long as it is reasonable and consistent with earlier and later pronouncements." March Op., at 24-25 [Dkt. 101]. But, because

[124] *See* Alpine's Add'l SOF, ¶¶ 179, 181-182, 189, 193, 199-200, 204-205, 208, 210, 212, and 213 [Dkt. 154].

FinCEN is not a litigant here, the court applied this holding to imbue the *SEC's* view of FinCEN's guidance with the "force of law," such that noncompliance therewith can constitute a violation of the SAR regulations.[125] This is plain error, not only because FinCEN's informal guidance does not have the "force of law," but also because the Court deferred to the wrong agency. It is not FinCEN advocating for this mechanical interpretation of its guidance nor, as indicated in Section A above, has it ever endorsed the enforcement approach reflected in this case.

As confirmed by the Supreme Court in *Kisor*, an agency's interpretation is entitled to deference only where it is "actually made by *the agency*" in which Congress vested interpretive power, and only where it is a deliberative utterance from an "actor best position[ed] to develop expertise about the given problem." *Id.*

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[125] Guidance which does not undergo notice and comment procedures of the APA is not entitled to *Chevron* deference and cannot impose substantive obligations upon which a violation could be predicated. *See Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, 1204 (2015) ("'Interpretive rules 'do not have the force and effect of law and are not accorded that weight in the adjudicatory process.'") (citation omitted); *Christensen v. Harris Cty.*, 529 U.S. 576, 587 (2000) ("Interpretations such as those in opinion letters—like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant Chevron-style deference.").

In fact, this district court previously ruled that "FinCEN Guidance" does not have the "force of law." *United States v. Budovsky*, No. 13-cr-368 (DLC), 2015 WL 5602853, at *10 (S.D.N.Y. Sept. 23, 2015); *accord Donovan v. Skandia Inv. Holdings Corp.*, No. 02CV9859 (MP), 2003 WL 217572260, at *1 (S.D.N.Y. July 31, 2003) ("NASD notices, however, are not law and noncompliance therewith cannot itself constitute a violation of the federal securities laws.") (emphasis added). The district court did not explain or acknowledge its inconsistent approach here.

at 2417 Deference is "unwarranted," where the interpretation propounded by the agency "does not reflect an agency's authoritative, expertise based, fair or considered judgment." *Kisor,* 139 S.Ct. at 2416.

The district court's deference to the SEC contravened both of these essential components of the *Kisor* decision. In relation to the BSA, it is *Treasury's* view that matters because enforcement of the SAR provisions "falls within the scope of . . . [Treasury's] authority." *See id.* In addition, the court fashioned statutory violations from portions of industry publications that were neither authoritative, nor in some instances even authored by FinCEN.[126] The court relied extensively, for example, on a periodic publication called "Tips and Trends," *see* March Op., at 47-67 [Dkt. 101], December Op. at 52-96 [Dkt. 174]. This publication is a collection of various comments from different agencies including the SEC and FINRA which bore no indicia that it was considered the authoritative pronouncements of FinCEN, and which even included cautionary language stating that they cannot be relied upon as even presenting the views of *the SEC*.[127] Such statements are not

[126] Alpine's expert, who was involved in those publications, provided an explanation of the somewhat informal process that resulted in those "Tips" being published. *See* Alpine's Expert Report, ¶¶ 129-133 [Dkt. 137]. The Court disregarded that report in connection with the motion for summary judgment. *See* Alpine's Request for Leave to Submit its Expert Declaration [Dkt. 114-116] and Court's Denial [Dkt. 117].

[127] *See* "SAR Activity Review – Trends, Tips & Issues," Issue 15, Ex. 202 to Alpine's Add'l SOF [Dkt. 154], at 20 (stating that pages 20-25 were prepared by FINRA and the SEC, and that "[t]he views expressed in this document do not necessarily represent the views of the Commission, or the members of the staff of the Commission.").

entitled to deference. *Kisor*, 139 S.Ct. at 2417 (where "the agency itself has disclaimed the use of regulatory guides as authoritative," a court may not defer to the interpretation (quotations and citation omitted)).

Furthermore, the section from *SAR Activity Review* Issue #15 containing the red flags utilized in the court's analysis was authored by the SEC, *not* FinCEN, to describe their "common examination findings," and was never intended to create SAR narrative content requirements.[128] Such publications were never intended to be used to construct rigid rules and had none of the deliberative qualities that *Kisor* made clear are the prerequisite to judicial deference. The Court's treatment of this guidance was clearly erroneous and should be reversed.

D. Punishing Alpine Based on the Newly Created Red-Flag Rules Deprived Alpine of its Constitutional Right to Fair Notice.

Even assuming the SEC had authority under Rule 17a-8 to pursue an enforcement action predicated on a violation of the SAR regulations under the BSA, it does not have the authority to graft requirements or regulations onto those regulations, particularly for the first time in litigation. In cases where civil monetary penalties are sought, the law is clear that an agency must give "fair warning" that allegedly violative conduct was prohibited, and courts will reject an

[128] *See* "SAR Activity Review – Trends, Tips & Issues," Issue 15, Ex. 202 to Alpine's Add'l SOF [Dkt. 154], at 20-25

agency's expansive interpretations and application of a regulation for the first time in litigation. *See, e.g., Christopher*, 567 U.S. at 155–57 and n.15.[129]

By holding Alpine liable under the SEC's new theories of liability, and going the further step of imposing an unprecedented penalty against Alpine for these "violations," the district court failed to adhere to these principles and deprived Alpine of its constitutional right to fair notice.

[129] *Accord General Elec. Co. v. E.P.A.*, 53 F.3d 1324, 1329 (D.C. Cir. 1995) (observing that an agency's use of "'citation [or other punishment] as the initial means for announcing a particular interpretation," or "for making its interpretation clear" may "raise a question of the 'adequacy of the notice'"); *Gates & Fox Co. v. O.S.H.A.*, 790 F.2d 154, 156-57 (D.C. Cir. 1986) (setting aside agency sanction where it failed to provide a regulated entity with "constitutionally adequate notice" of what was required, and holding that pre-suit warning was not adequate where it "was not an authoritative interpretation of the regulation").

POINT IV
The District Court Erred In Holding That The Facts And Circumstances Of Alpine's Program And Filings Were Irrelevant To The Issue Of Whether Its Sar Filings Violated The BSA

Based on the stack of "red flag" rules that it had formulated, the district court went the further step of holding that those rules can be applied, and liability can be imposed, without consideration of the firm's SAR analysis or program, the facts and circumstances of the transaction, or the presence within the SAR support file of evidence that the firm had considered the particular issue and customer and had identified "green flags" that caused the firm not to regard a particular issue or transaction as suspicious.[130] In doing so, the district court ignored pervasive issues of fact that should have precluded summary judgment.

A. Material Issues of Fact Existed With Respect to Whether Alpine's SARs Were Mandatory

The district court first erred in disregarding issues of fact regarding whether the SARs at issue were mandatory filings. The district court adopted the SEC's proposed test – a large deposit of low-priced securities plus one red flag – as a shortcut to liability. But it is not, and cannot be so simple; a red flag cannot be a

[130] *See, e.g.*, 66 Fed. Reg. at 67,673 (FinCEN notice for broker-dealer SAR rule) ("Different fact patterns will require different types of judgments . . . . [including] whether the facts and circumstances and the institution's *knowledge of its customer provide a reasonable explanation for the transaction that removes it from the suspicious category*). Here, a small subset of customers accounted for most of the SEC's claims, and Alpine had extensive knowledge regarding those customers. *See* Alpine's Add'l SOF, ¶¶ 187-188 [Dkt. 135] (1466 out of 1594 transactions involved only 6 customers to which Alpine was very familiar and tracked their history in the filed SARs).

reason to automatically suspect criminal activity in every transaction regardless of the facts and circumstances. Not only have *all* the regulators stated this, as indicated in Point III above, but the SEC's expert confirmed, and Alpine's expert agreed, that "[t]he presence of red flags alone, of course, does not mean that a transaction is suspicious and reportable."[131] By providing only summary check the box charts and generalized testimony from its expert that a red flag could, in some circumstances, be indicative of a crime, the SEC failed to carry its burden to show, on an undisputed factual record,[132] that a "reasonable broker-dealer" in Alpine's "circumstances would have suspected th[at] [each] transaction was subject to SAR reporting." 67 Fed. Reg. at 44, 053.

The threshold issue of whether a SAR filing was required was particularly critical in this case because Alpine demonstrated it filed a substantial quantity of SARs, *not* because it believed that the transaction met any of the categories of a required SAR filing, but because it understood from its discussions with FINRA

[131] Alpine's Expert Rebuttal Report, ¶ 184 [Dkt. 137] (quoting Navigant Expert Report, at 20).

[132] Certainly, the SEC's expert herself disputed this facile assumption by stating that "red flags alone" do not make a transaction suspicious. *See id., supra*. Additionally, Alpine's expert also disputed such contentions, as both general proposition and with respect to each red flag at issue. Alpine's Expert Rebuttal Report [Dkt. 137] ¶¶ 180-86, 193-95 (general propositions); ¶ 220 (criminal or regulatory history); ¶¶ 24, 226-27 (shell company and other "derogatory" stock history); ¶ 230 (stock promotion and "unverified issuers"); ¶¶ 233-34 (low trading volume); ¶ 239 (foreign involvement); ¶¶ 241-44, 247 (deposit-liquidation "patterns").

that it should file SARs to report large deposit of low-priced securities.[133]

Notwithstanding the uncontroverted evidence that Alpine filed what would constitute voluntary SARs, the district court sharply rejected that contention, even insisting that the mere assertion of that fact reflected a "lack of remorse" and warranted increased penalties against the firm.[134] Instead, according to the district court, the bare fact that the SARs were filed demonstrates that they were mandatory and, because they were mandatory, but did not articulate "why" the transaction was suspicious, they violated the BSA. December Op., at 46 [Dkt. 174] ("Moreover, it is not unreasonable to infer from Alpine's very act of filing a SAR that the reported transaction had sufficient indicia of suspiciousness to mandate the creation and filing of a SAR"). That circular reasoning plainly makes no sense when viewed in the context of Alpine's filings and the abundant evidence that it filed SARs even when it did not consider the transaction to be suspicious, but it was used by the district court to relieve the SEC of the burden of proving the essential element of an alleged SAR violation: that the filing was required.

B. Material Issues of Fact Existed Regarding Whether Alpine's SAR Filings Were "Deficient"

The district court erred in holding that it could grant summary judgment

[133] *See* Alpine's Add'l SOF, ¶¶ 47, 69, 72, and 75 [Dkt. 154]. Among the SARs filed by Alpine that the SEC selected for this case, 213 fell below the $5,000 threshold, and so were obviously not required filings. *See Id.* at ¶ 162.
[134] *See* Order on Remedies, at 27-28 [Dkt. 235].

against Alpine, without regard for the facts and circumstances presented by Alpine, because of the purported "inadequacy" of its SAR narratives. An issue of fact existed, first, based on the testimony of Alpine's expert witness. That expert not only confirmed the inherent subjectivity of the SAR analysis but also expressly stated that Alpine's SARs did not violate the BSA, and that its decisions not to include certain items in the SAR narratives were consistent with the conduct of a reasonable broker-dealer in those circumstances.[135] That testimony, at a minimum, raised an issue of fact as to whether Alpine's conduct violated the BSA that precluded a grant of summary judgment.

The district court also, without basis or explanation, took its assumptions from its review of "exemplar SARs" and applied them to its adjudication of *all* of the SARs at issue. In the first summary judgment motion, the SEC presented to the district court the briefest of Alpine's SAR narratives, focusing primarily on SARs that followed the format used by Alpine when it was reporting the transaction but had *not* found the transaction suspicious. The district court reviewed only that handful of SARs cherry-picked by the SEC. Not surprisingly, the court held that summary judgment was appropriate against Alpine because the SAR narratives in the "exemplar" SARs were "woefully inadequate" or "opaque." March Op., at 48, 51, 55, 56, 65 [Dkt. 101].

[135] *See* Alpine's Expert Report, at ¶¶ 182-186, 188-191, 193-205 [Dkt. 137].

The district court acknowledged, however, that the analysis of whether a SAR narrative is "deficient" is "necessarily context-specific," and that a "fulsome" narrative would not be susceptible to summary judgment. March Op. at 65 [Dkt. 101]. Nonetheless, on the SEC's second motion for summary judgment, without any regard for the length and breadth of the narratives contained in other SAR filings, the district court applied its conclusion of "inadequacy" to the thousands of other SARs at issue.

The district court possessed no basis for any conclusion regarding the adequacy of the narratives of all of the SAR narratives at issue.[136] The record was replete with documentary and testimonial evidence disputing any finding that all of the SARs at issue in the case followed the particular format that the district court considered to be "inadequate." Alpine also, in the same time frame, routinely filed SARs to report transactions it actually found suspicious and included extensive descriptions and explanations of the factors that caused the firm to find the transaction suspicious.[137] Notwithstanding submission of those SARs to the district court, and discussion regarding the substantial improvements in Alpine's SARs from 2012 forward, the district court never addressed or even considered the

[136] As discussed above, the SEC never provided the bulk of the SARs to the district court. It provided only a summary chart from its expert that literally checked boxes if particular red flag items were present in the SAR files, or if the SAR was allegedly "facially deficient."
[137] Alpine's Add'l SOF, ¶ 89 [Dkt. 154].

extent to which the SARs at issue were more "fulsome" than the exemplars used by the SEC such that summary judgment was not appropriate. *See* December Op., at 53-54 [Dkt. 174].

C. The District Court Ignored Evidence of Alpine's Process for Reviewing the Transactions at Issue

Alpine detailed for the district court the fact that the SAR files that were reviewed by the SEC's expert contained not just the identified red flag but also other information that reflected Alpine's consideration of that issue, and its receipt of information that explained or "cleared" the flag. Those support files, as well as Alpine's expert, raised factual disputes regarding application of the guidance within each of the SEC's "red flag" categories.

The district court's refusal to consider evidence relating to Alpine's process and its SAR filings is more egregious given the extent of that evidence. Each of the witnesses confirmed that no one at Alpine ever consciously omitted any pertinent information from a SAR narrative or attempted to evade the SAR filing rules in any manner.[138] With respect to the filing of SARs, Ms. Farmer explained that she acted diligently to understand the BSA requirements and apply them in the context of the business in which she was employed and with a focus on the

[138] Alpine's Add'l SOF, ¶¶ 109, 116 [Dkt. 154].

particular risks associated with Alpine's business.[139] Ms. Farmer also testified that she was aware and relied on the ruling in *Sterne Agee,* the leading published opinion at the time which had flatly rejected the notion that there were hard-and-fast rules for the content of a SAR narrative, and held that the firm was reasonable in including in the narrative those circumstances that it considered significant while excluding other red flag characteristics.[140] The failure to include particular items of "red flag" information in the narrative of the SAR was not the result of a disregard of a known obligation; it was, in her view, consistent with FinCEN's repeated direction that the firm state in the SAR narrative the firm's reason for filing the SAR.

> [A red flag] is simply a trigger. It's simply a flag or something that we would then review, monitor more carefully, look more closely to determine whether it really truly – whether the activity, based on what we knew about the client either directly or indirectly, meaning through the introducing broker-dealer, would be enough to determine whether to file or not file a SAR.[141]

The evidence demonstrated that, in each of the red flag categories, Alpine considered and reviewed those circumstances, often cleared them through its

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[139] *Id.* ¶¶ 83, 97, 104, 219.

[140] *See In re Sterne, Agee & Leach, Inc.*, No. E052005007501, at 32-33 (Mar. 5, 2010) found at: https://www.sec.gov/litigation/admin/2015/33-9844.pdf.

[141] Alpine's Add'l SOF, ¶ 50 [Dkt. 154]); *Id. at Suspicious Activity Reporting – Overview* ("By their nature, SAR narratives are subjective, and examiners generally should not criticize the [financial institution's] interpretation of the facts.").

analysis, and also included a reference to them in the narrative where they contributed to the firm's finding of suspiciousness.[142]

D. The District Court Erred By Ignoring Evidence that Alpine Maintained and Produced All Support Files at Issue

The district court's ruling granting summary judgment for the SEC on its evolving claim that Alpine failed to maintain SAR support files is confused and erroneous. The SEC claimed that Alpine violated Section 1023.320(d) of the BSA by failing to maintain 1,249 SAR support files.[143] Alpine proved this claim was meritless by producing all of the support files in discovery and submitting an affidavit, in connection with the first summary judgment proceeding, from Alpine's then chief compliance officer stating that the files were initially gathered and provided to Alpine's counsel for production to the SEC during the pre-suit investigation phase in 2016.[144]

In response to this evidence, the district court initially denied summary judgment for the SEC on this claim in its March 2018 decision. March Op., 75-77 [Dkt. 101]. But, rather than dismissing the claim, the court suggested the SEC

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[142] *See e.g.* Alpine's Add'l SOF, ¶ 198 [Dkt. 154] (chart showing analysis in the support file resolving each SAR in the shell company or derogatory history of stock category); *id.* ¶ 203 (chart showing analysis in the support file resolving each SAR in the stock promotion category); *id.* ¶ 207 (chart showing analysis in the support file resolving each SAR in the unverified issuer category).

[143] Comp., ¶ 42 [Dkt. 1]; Table E, Ex. 248 to Alpine's Add'l SOF [Dkt. 154].

[144] Alpine's Add'l SOF, ¶¶ 254-259 [Dkt. 154].

could still pursue this claim on an alternative, and unpleaded, basis if it could prove Alpine failed *to produce* the files during the pre-suit investigation. *Id.*

The SEC then moved for summary judgment on the theory that Alpine failed to produce 496 support files in 2016. SEC's Mot., at 1 [Dkt. 146]. The SEC supported this argument with a declaration from the SEC employee that conducted the investigation, James Lyman, who Alpine had not been permitted to depose.[145] Mr. Lyman stated that he re-reviewed Alpine's 2016 production in anticipation of summary judgment, using different search parameters than he used to initially identify the purportedly "missing" support files, and that he was still unable to locate 496 support files within Alpine's 2016 production, effectively conceding he had located over 750 support files the SEC previously claimed were "missing."[146]

The district court did not address Alpine's evidence or provide any explanation of how it resolved the clear factual dispute in the SEC's favor on summary judgment. Instead, it disregarded Alpine's evidence, stating "Alpine has not provided evidence that it ever provided the SEC with the support files for these 496 SARs." December Op., at 98 [Dkt. 174]. The court then stated, "[i]f Alpine maintained the missing files, then all it needs to do to defeat this prong of the SEC's motion is to produce them now," and that doing so would "likely have . . .

[145] *See* Lyman Decl., Ex. 19 to SEC's Mot. [Dkt. 148]; *see also* Alpine's Response to SEC's SOF 43, 53 [Dkt. 154].
[146] Lyman Decl., ¶¶ 5-7, 9, Ex. 19 to SEC's Mot. [Dkt. 148].

mooted" the SEC's claim. *Id.* (emphasis added). But Alpine had already provided precisely that evidence, that it both maintained and produced the files; even the SEC did not claim otherwise.[147] The district court thus plainly erred by granting summary judgment for the SEC on this claim.

POINT V
THE DISTRICT COURT ABUSED ITS DISCRETION IN IMPOSING AN UNPRECEDENTED, AND GROSSLY EXCESSIVE $12 MILLION PENALTY AGAINST ALPINE

The district court's imposition of an unprecedented "tier 1" $12 million penalty against Alpine was based on a confluence of errors: the court expressly penalized Alpine for appropriate litigation positions; it improperly relied on inadmissible items of evidence; and it purported to reach factual findings that disregarded the extensive evidence of Alpine's development and substantial improvement of its compliance programs.[148] Infecting the entirety of the district court's penalty determination was its conclusion that Alpine acted with "scienter." Throughout the proceedings, and in relation to penalties, Alpine had put forth extensive evidence of the reasonableness of its program and its conduct. The court

[147] *See* Alpine's Response to SEC's SOF No. 53 [Dkt. 154].

[148] Subject to statutory maximum penalty amounts within each tier, the amount of the penalty is within the discretion of the district court, *SEC v. Razmilovic*, 738 F.3d 14, 38 (2d Cir. 2013) and should be determined "in light of the facts and circumstances" of the violation. "A district court abuses its discretion if it (1) bases its decision on an error of law or uses the wrong legal standard; (2) bases its decision on a clearly erroneous factual finding; or (3) reaches a conclusion that, though not necessarily the product of a legal error or a clearly erroneous factual finding, cannot be located within the range of permissible decisions." *Klipsch Grp., Inc. v. ePRO E-Commerce Ltd.*, 880 F.3d 620, 627 (2d Cir. 2018).

had consistently responded that Alpine's intent was not relevant because Rule 17a-8 is a strict liability provision. On that same basis, the court even denied discovery to Alpine regarding certain FINRA and OCIE reports on the ground that they "are not the source of any legal obligation or of any finding that Alpine violated Section 1023.320," and are relevant "solely to give context to arguments *Alpine has made*." December Op., at 34, n.36 [Dkt. 174] (emphasis added).

When it reached the issue of penalties, the district court reversed course, focusing improperly on comments made by OCIE in the same examination report that Alpine had not been permitted to challenge and that was admitted only for a limited purpose. The contentions contained in the OCIE report were embraced and credited by the court, forming the basis for its conclusion that "Alpine acted knowingly and with disregard for its obligations under the law." Order, at 22-25 [Dkt. 235]. That finding, predicated on the inadmissible and unsupported assertion of an OCIE examiner and contradicted by substantial record evidence of Alpine's AML program, was clearly erroneous.

The other prong of the district court's finding of scienter, its arguments regarding Alpine's litigation position, constituted both factual and legal error. The district court, inexplicably, repeatedly and harshly criticized Alpine for its assertion that the SEC had failed to establish that the SARs at issue were

mandatory filings under Section 1023.320(a)(2).[149] The district court appeared to suggest that Alpine's contention was unsupported, even that it was developed only for the litigation. But that was plainly contrary to undisputed evidence: Alpine's policy and practice was documented in contemporaneous communications, and even in the SARs themselves.[150]

Adding to that erroneous factual finding was the clear legal error of using against Alpine its properly developed and relevant arguments which are neither competent evidence of Alpine's scienter at the time of the transactions nor a proper basis for imposition or enhancement of a penalty. *See In re Workers' Comp. Refund*, 46 F.3d 813, 822 (8th Cir. 1995) (holding a "litigation penalty" can violate the constitutional right to access the courts where it includes "retaliatory action . . . designed to either punish [an individual] for having exercised his constitutional right to seek judicial relief or to intimidate or chill his exercise of that right in the future"); *SEC v. First City Financial Corp.*, 890 F.2d 1215, 1229 (D.C. Cir. 1989) (Defendants are not to be punished because they vigorously contest the government's accusations); *accord SEC v. Johnson*, No. 03 CIV. 177 (JFK), 2006 WL 2053379, at *6 (S.D.N.Y. July 24, 2006) (adopting the D.C. Circuit's

[149] *See* Order, at 23 [Dkt. 235] (stating that "Alpine has maintained this position notwithstanding warnings from FINRA and OCIE and *despite Opinions of this Court ruling otherwise*") (emphasis added).
[150] *See e.g.* Alpine's Add'l SOF, ¶¶ 60-74 [Dkt. 154].

rationale, and refusing to penalize defendant for "simply mounting a vigorous defense"); *cf. WHX Corp. v. SEC*, 362 F.3d 854, 860-61 (D.C. Cir. 2004) ("Finding a violation 'serious' and 'willful' simply because of a failure to comply immediately with the staff's interpretation . . is arbitrary and capricious . . . ."). Because those errors formed the basis for the district court's enhancement of the penalty, that penalty should be vacated and remanded.

Finally, the district court abused its discretion through the sheer, unprecedented amount of the penalty. The $12 million "tier 1" penalty is exponentially greater than the maximum penalty amount that would be imposed under the comparable penalty provisions of the BSA. Under 31 U.S.C. § 5321(a)(6), the maximum penalty for a negligent violation of Section 1023.320 is $500.00 per violation, for a total maximum penalty amount of $1.36 million for all violations found by the court. As explained above, the penalties for a violation of this regulation cannot change based on the identity of the agency that brings an enforcement action, even assuming *arguendo* the SEC had the authority to pursue that enforcement action. It is neither logical, lawful nor constitutional that a defendant could face a maximum penalty of $500 per negligent violation of § 1023.320 in all contexts except when the SEC is the plaintiff, where liability catapults to a maximum of $80,000 for the exact same violation, of the exact same regulation, committed with the exact same mental state. The district court erred in

its disregard of the fundamental principle that a statute's specific penalty provisions cannot be ignored or "eclipsed." *Loving*, 917 F. Supp. 2d at 76.

Even using the penalty structure of the Exchange Act, the penalty of $12 million is so excessive as to be outside the bounds of a permissible result. As Alpine established in the district court, the series of cases involving multi-year and "recurrent" violations of Rule 17a-8, including failures to file SARs, have resulted in penalties ranging from $65,000 to $800,000.[151] Here, there was no evidence of illicit gain, no victim losses, no fraud, and no legitimate basis to impose a penalty so grossly in excess of those imposed in analogous circumstances. *SEC v. Collins*, 736 F.3d 521, 527 (D.C. Cir. 2013) (although adherence to "mechanical formulae" is not required, penalty determinations should not be "oblivious to history and precedent" or "out of line with the agency's decisions in other cases"); *Rapaport v. SEC*, 682 F.3d 98 (D.C. Cir. 2012) (reversing administrative penalty determination and stating that agencies "may not depart from precedent without explaining why").

Finally, the court erred both factually and legally in disregarding the abundant and uncontroverted evidence of Alpine's financial condition and imposing a penalty amount that is well beyond Alpine's ability to pay and would

[151] *See* Alpine's Opp. to SEC's Mot. for Remedies, at pp. 6-7 [Dkt. 205] (compiling comparable cases with citations include hyperlinks to each administrative proceeding).

force the closure of the firm. "A defendant's finances are relevant to the size of a civil penalty." *SEC v. Robinson*, 2002 WL 1552049, at *12 (S.D.N.Y. July 16, 2002). In fact, "courts recognize that a defendant's net worth is a ***critical factor*** in determining the amount of civil penalty to award." *SEC v. Clay Capital Mgmt.*, 2013 WL 5946989, at *8 (D.N.J. Nov. 6, 2013).

Alpine submitted a clear and unrefuted picture of its current financial condition, based on reports it is required to file monthly with the SEC, demonstrating that any penalty greater than the firm's excess net capital of roughly $800,000 would force it out of business. The SEC did not dispute these figures but argued that the court should also look the financial condition of Alpine's ownership in evaluating *Alpine*'s ability to pay the penalty.[152] Alpine established that the SEC's position is contrary to law; the resources of parents, owners and subsidiaries is not properly considered in relation to a defendant's penalty.[153] The district court asserted that it agreed with Alpine, that the resources of others are not relevant, but then proceeded to rely upon Alpine's *past* distributions to its owners to conclude that Alpine had a *present* ability to pay. Because the court, by considering amounts transferred to its parent, employed an improper analysis, its penalty determination should be reversed.

[152] *See* SEC's Reply Mem., at 20-22 [Dkt. 213].
[153] *See* Alpine's Mem. in Supp. of Mot. to Strike, at 9-13 [Dkt. 218].

CONCLUSION

Based on the foregoing, Alpine respectfully requests that this Court reverse the District Court's judgment against Alpine.

Dated: New York, New York
January 6, 2020

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) in that it is 20,750 words.

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) in that it is proportionately spaced typeface Times New Roman using 14-point type by the Microsoft Word program.

Dated: New York, New York
January 6, 2020

Respectfully submitted,

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