No. 22-1241

In The
Supreme Court of the United States

JOCELYN M. MURPHY, MICHAEL S. MURPHY, AND RICHARD C. GOUNAUD,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF INVESTOR CHOICE ADVOCATES NETWORK AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

IDENTITY AND INTEREST OF *AMICUS CURIAE*[1]

Amicus curiae Investor Choice Advocates Network ("ICAN") is a nonprofit organization seeking to expand investor opportunities to participate in the capital markets and reduce regulatory barriers to entry to those markets. ICAN is concerned that the Ninth Circuit's opinion may create just such a barrier to participation in the capital markets. Requiring registration as a securities broker imposes costs, costs ultimately borne by investors, and the Ninth Circuit's ruling creates ambiguity regarding who must register and bear those costs. As a result, some potential market participants will simply not participate in some investment activity out of fear of violating an ambiguous regulatory requirement. Other market participants will incur the expense necessary to register as securities brokers in situations where such registration yields no corresponding benefits to investors. Preventing obligations (or the perception of potential obligations) to register as a broker beyond what the federal securities laws require is an issue of great importance for the public and ICAN.

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no party or counsel for a party, or any other person other than *amicus curiae* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Counsel for *amicus curiae* provided notice of this brief's filing to counsel for the parties more than 10 days before its filing. *See* Sup. Ct. R. 37.2.

SUMMARY OF THE ARGUMENT

The Ninth Circuit's opinion in this case holds in relevant part that Petitioners were required to register with Respondent Securities and Exchange Commission ("SEC" or "Commission") as brokers because Petitioners put a third party's capital at risk and acted as his agents. The Ninth Circuit's opinion appears at times to abandon the long-standing framework for determining whether conduct creates an obligation to register as a broker. While ostensibly deriving its result directly from statutory text, the Ninth Circuit's new framework in fact goes beyond what the statutory text supports (and appears to exceed any standard articulated by the SEC in the underlying case). Ambiguities in the Ninth Circuit's opinion could be read to create a new, dramatically sweeping broker registration obligation for segments of the economy that even the SEC has not suggested require such registration. Such a result would impose costs on investors, reduce choices available to investors, and, accordingly, would be against public policy.

ARGUMENT

I. The SEC Silences Investors When It Pursues Jurisdictional Expansion Through Litigation

The Commission's action in this case appears designed to expand its jurisdiction through piecemeal litigation involving the term "broker" rather than through rulemaking or by seeking statutory authority from Congress.

When the SEC attempts to increase or decrease its jurisdiction through rulemaking, the public (including investors) has the opportunity to comment, and challenge in court, the extent of applicable statutory authority in a transparent and predictable manner. *See*, *e.g.*, *Digital Realty Trust, Inc. v. Somers*, 583 U.S. ___ (2018) (SEC promulgated rule expanding "whistleblower" beyond statutory limitations in Dodd-Frank Act); *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) (SEC promulgated rule expanding "client" beyond statutory authority in Investment Advisers Act of 1940); *FinancialPlanning Ass'n v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (SEC promulgated rule defining "investment adviser" in a manner inconsistent with the Investment Advisers Act of 1940).

In sharp contrast to the broadly public, transparent rulemaking approach to jurisdictional questions, in recent years the Commission has brought numerous enforcement actions urging expansive definitions of jurisdictional terms that, if adopted by courts, would have an enormous impact on the investing public. *See, e.g., SEC v. Almagarby*, 479 F. Supp. 3d 1266 (S.D. Fla. 2020), *appeal pending*, No. 21-13755 (11th Cir.) (SEC pursuing expanded definition of "dealer"); *SEC v. Keener*, 2020 WL 4736205 (S.D. Fla. Aug. 14, 2020), *appeal pending*, No. 22-14237 (11th Cir.) (same).

In SEC litigation, as opposed to SEC rulemaking, the SEC actively excludes investors from participating. *See, e.g., SEC v. Everest Mgmt. Corp.*, 475 F.2d 1236, 1240 (2d Cir. 1972) (upholding order granting SEC's opposition to investors' motion

to intervene in SEC enforcement action). In other words, when the SEC seeks to expand its jurisdiction through piecemeal litigation rather than through rulemaking, the SEC intentionally excludes investors from the process.

The SEC does not appear to have solicited any investor input in litigating this case. Indeed, the SEC did not allege any harm to investors caused by the Petitioners' conduct. As a result, no one advocating on behalf of investors had an opportunity to provide input on the public policy impact of the SEC's proposed expansion of the term "broker" as would have been the case had the SEC pursued such an expansion through public rulemaking.

II. An Overbroad Interpretation of "Broker" is Against Public Policy And Will Adversely Impact Investors

Requiring SEC registration as a broker comes at considerable burden and expense—a burden and expense borne by investors in the form of increased expenses and decreased options when selecting intermediaries for investment transactions.

Registration as a broker under Section 15 of the Exchange Act "triggers numerous other sections of that Act, as well as rules promulgated pursuant to those sections." Lipton, A Primer on Broker-Dealer Registration, 36 Cath. U. L. Rev. at 907. Among other things, registered brokers must file a Form BD and a statement of financial condition; registering brokers, and all natural persons associated with them must meet regulatory standards of competency

and training by, for example, adequate performance on examinations administered by self-regulatory organizations. Once registered, a broker must comply with specific record keeping, financial compliance, and financial reporting requirements, including maintenance of numerous records regarding, among other things, securities transactions, position held in securities, orders received and given, as well as the receipt and disbursement of various funds. Brokers must prepare and file quarter financial reports and certified annual reports. Brokers are subject to rigorous net worth and capital requirements, must join an insurance program to cover certain customer losses, and must join a self-regulatory organization. This incomplete list of regulatory burdens imposed on brokers should not be imposed lightly, particularly in a case in which the SEC does not allege any harm to investors or any complaints regarding the absence of such registration.

One industry study and report concluded that firms in the securities industry spent $23.2 billion in 2004 on regulatory compliance, and "[t]he costs incurred by firms in the securities industry to comply with the increasing volume of regulatory and legislative initiatives **may ultimately be passed on to investors through higher prices and fewer choices**." Securities Industry Association, The Costs of Compliance In the U.S. Securities Industry (Feb. 2006) (emphasis added).

In short, an overly-inclusive definition of "broker" imposes regulatory costs. To be sure, those costs are borne in part by those who choose to be

securities "brokers," but the costs are also borne indirectly by those who forgo becoming securities brokers or forgo economic activity that falls outside of any reasonable definition of the term "broker" because of uncertainty created by an ambiguous definition in the hands of an assertive regulator. This case—a case in which no investor was harmed and no investor ever sought the protections that the Ninth Circuit's opinion seeks to impose—is not the right case in which to create an overly expansive definition of the term "broker."

III. The Ninth Circuit's Opinion Departs from Precedent

The Ninth Circuit's opinion opens with a laudable premise: beginning its analysis with the relevant statutory language rather than with the significant body of case law that has developed around the statutory language. 18a & 19a. The Ninth Circuit contrasts the "broad," case-driven "totality-of-circumstances approach" set forth in *SEC v. Feng*, 935 F.3d 721, 732 (9th Cir. 2019) (alteration in original) (citation omitted) (applying *SEC v. Hansen*, No. 83 Civ. 3692, 1984 U.S. Dist. LEXIS 17835, at *25 (S.D.N.Y. Apr. 6, 1984) (the "*Hansen* factors") with the "straightforward" language in Sections 3(a)(4) and 15(a) of the Securities Exchange Act of 1934 ("Exchange Act"). *Id.*

As the Ninth Circuit's opinion notes, Exchange Act Section 3(a)(4)'s definition of "broker" is very simple on its face: "any person engaged in the business of effecting transactions in securities for

the account of others." 15 U.S.C. § 78c(a)(4)(A) (quoted at 18a). Although the SEC did not request the Ninth Circuit to reject the *Hansen* factors, the Ninth Circuit's opinion "does not rely on the *Hansen* factors," and the concurring opinion would jettison the *Hansen* factors altogether. 25a and 41a. However, the *Hansen* factors arose to fill gaps left by the statutory definition's superficial simplicity. David A. Lipton, *A Primer on Broker-Dealer Registration*, 36 Cath. U. L. Rev. 899 (1987) (describing multi-decade development of broker definition and concluding, "Initially, the answer to that question (of who is a broker) appears relatively simple. . . . Unfortunately, this common understanding of the broker-dealer does not provide guidance for determining broker status in other than the customary securities industry situation").

The Ninth Circuit's opinion implicitly recognizes that the statutory definition alone provides insufficient structure to address the facts of the present case. Rather than limiting its analysis to the bare statutory language, the Ninth Circuit's opinion creates what appears to be a new, two-factor test in place of the *Hansen* factors:

> First . . . when Appellants traded securities and shared a portion of the profits and losses with Riccardi, they traded for his account because another person—Riccardi—bore some risk of a loss.
>
> Second, Appellants traded 'for' Riccardi because they acted as his 'agents.' . . .

> [because] Appellants acted on Ricardi's behalf and subject to his control.

20a & 21a.

Unfortunately, replacing the seven *Hansen* factors with what would undoubtedly become known in subsequent cases as the two *Murphy* factors does little to assist predictability of results and may do harm by inadvertently including business models that no one (including, apparently, the SEC) believes require registering as a broker.

IV. The Ninth Circuit's Opinion May Require Broker Registration for Large Swathes of the Market Not Currently Registered

The Ninth Circuit's opinion may be read to require broker registration for (1) a group of individuals sharing trading in profits and losses, and (2) when one or more members of such a group executes trades through a prime brokerage account. Such a registration requirement would come as a surprise to many investment clubs and investment advisers.

A. The Ninth Circuit's Opinion May Require Investment Clubs to Register as Brokers

The SEC's Office of Investor Education and Advocacy describes an investment club as "a group of people who pool their money to invest together. Club members generally study different investments and then make investment decisions together – for example, the group might buy or sell

based on a member vote."[2] The SEC OIEA goes on to advise that while the "SEC generally does not regulate investment clubs," certain regulatory requirements may exist depending on the structure of a specific club. The listed potential "registration requirements" include (1) registration of the offer and sale of club membership interests, (2) registration of the club as an investment company, and (3) registration as an investment adviser for any person paid for providing advice regarding the club's investments. Conspicuously absent from list of "registration requirements" is the possibility that the member tasked with executing the club's transaction through a brokerage firm must herself be registered as a broker.

To be sure, the SEC OIEA description of potential investment club "registration requirements" is not meant to be legal advice from the SEC, but the absence of any mention that investment club members may need to register as securities brokers is telling: it would be more than surprising to suggest a broker registration requirement for a member of a group of people who share in the profits and losses generated from an investment pool because that person executed transactions for the group.

Such a registration requirement would apparently also surprise the National Association of Investors (a/k/a BetterInvesting), a

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[2] "Investment Clubs and the SEC," available at https://www.sec.gov/reportspubs/investor-publications/investorpubsinvclubhtm.html

national 501(c)(3) nonprofit established in 1951 that "has helped more than 5 million people from all walks of life learn how to improve their financial future."[3] In its publication, "How to Start a Stock Investment Club," BetterInvesting observes that "investing in the stock market is easier when sharing investing ideas and pooling investments as part of an investment club," and "When club members pool money and make investment decisions, the club treasurer can endorse member checks over to the club's broker." Adam Ritt, *How to Start a Stock Investment Club*, BetterInvesting (Aug. 5, 2019).[4] Nowhere does BetterInvesting suggest to its members that club members who execute trades through the club's brokerage account should register as brokers themselves. Again, BetterInvesting is not providing legal advice to its members, but the absence of any reference to the possibility that broker registration might be required suggests that the longstanding national leader in this area does not perceive that such a registration requirement risk is worth a passing mention.

One nonprofit, CLIMB (Communities Learning to Invest and Mobilize for Business), highlights the important role investment clubs can play in creatively and effectively connecting underserved

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[3] BetterInvesting: Who We Are, available at https://www.betterinvesting.org/.

[4] Available at https://www.betterinvesting.org/learn-about-investing/investor-education/joining-an-investment-club/how-to-start-a-stock-investment-club.

youth and families to financial education programs and resources.[5] Lack of financial education and literacy is a significant public policy issue: for example, one recent report found that only 31% of baby boomer generation workers said they have a great deal or quite a bit of understanding of asset allocation principles. *Id.*

The Ninth Circuit's opinion would create uncertainty for investment club members who execute trades through a brokerage account and share profits and losses with other members. Imposing a broker registration requirement (or the perception that one might exist) would decrease learning opportunities and worsen financial literacy. For the avoidance of doubt on this issue, the Court should grant Petitioners' petition.

B. The Ninth Circuit's Opinion Could be Read to Require Some Investment Advisers to Register as Brokers

The Ninth Circuit's opinion concludes that because Riccardi shared in the economic risks of Appellants' trades, Appellants traded for Riccardi's account and thus acted as unregistered brokers. 20a. Having relegated the *Hansen* factor of "transaction based compensation" to dicta (25a), the panel cites an inapposite speech by former SEC

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[5] Richard Eisenberg, *Why You May Want to Start, or Join, An Investment Club*, Forbes (Aug. 13, 2021), available at https://www.forbes.com/sites/nextavenue/2021/08/13/why-you-may-want-to-start-or-join-an-investment-club/?sh=2aa4f6da9bdb

Division of Trading and Markets (the "Division") Chief Counsel David Blass in support of the idea that sharing in profits and losses is the same as "transaction based compensation," but Mr. Blass's speech does not support that conclusion. 25a (quoting Blass, *A Few Observations in the Private Fund Space*, "compensation that depends on the outcome or size of the securities transaction"). While Mr. Blass's speech does not support the panel's conclusion equating profit and loss sharing with "transaction based compensation," the Ninth Circuit's reliance on the speech highlights a market segment that may be impacted by the panel's opinion: the private fund space.

Rather than relying on the *Hansen* "transaction based compensation" factor, the Ninth Circuit's opinion instead looks for support of its conclusion from a Third Circuit opinion interpreting an Exchange Act provision not at issue in this case. 20a (citing *Levine v. SEC*, 407 F.3d 178, 183-184 (3d Cir. 2005) and Exchange Act § 11(a)). However, the Ninth Circuit did not have to travel so far afield to encounter very common situations in which the very same SEC staff member relied on by the Ninth Circuit twice (18a and 25a), Mr. Blass, determined that sharing in the risk of trades did not create the need for securities broker registration.

In a pair of "no-action letters" issued by Mr. Blass, the Division stated that it would not recommend enforcement action under Section 15(a) of the Exchange Act if the parties engaged in the

described activities without registering as brokers.[6] Of relevance here, the Division found particularly compelling the fact that the investment adviser "will receive compensation equal to a portion of the increase in value, if any, of the investment as calculated at the termination of the investment in the Investment Vehicle (*i.e.*, carried interest)." . The Division further notes that an adviser who receives such carried interest compensation "will not receive any transaction-based compensation." *Id.* In other words, receiving compensation in the form of a portion of profits is not "transaction-based compensation" in the context of private funds and does not cause an investment adviser to become a broker requiring registration under Exchange Act Section 15(a).

While the facts of the current case can be distinguished from the facts present in the AngelList and FundersClub No Action Letters (*e.g.*, presence of a registered investment adviser; profits and losses shared on individual transactions rather than from a pooled investment), the Ninth Circuit's opinion leaves open the possibility that it could be used in the future to expand the broker registration requirement into the private fund space.

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[6] AngelList LLC, SEC No-Action Letter, 2013 WL 1279194 (Mar. 28, 2013) ("AngelList No Action Letter"); FundersClub Inc. & FundersClub Mgmt. LLC, SEC No-Action Letter, 2013 WL 1229456 (Mar. 26, 2013) ("FundersClub No Action Letter"). Contrary to the statement in Opn. fn 6, No Action letters are statements by SEC staff rather than "clarification from the SEC" itself.

The foregoing example involving carried interest compensation in a pooled investment is only one example of shared profits and losses in the investment adviser space. To conclude, as the Ninth Circuit's dicta does, that sharing in transaction profits and losses is equivalent to "transaction based compensation" under *Hansen*, creating an obligation to register as a broker would upend long-standing economic relationships that heretofore have not required such registration.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully Submitted,

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