

FOR PUBLICATION

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

DICHTER-MAD FAMILY PARTNERS,
LLP; PHILIP JAY DICHTER; CLAUDIA
GVIRTZMAN DICHTER; RICHARD M.
GORDON,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

No. 11-55577

D.C. No.
2:09-cv-09061-
SVW-FMO

OPINION

Appeal from the United States District Court
for the Central District of California
Stephen V. Wilson, District Judge, Presiding

Argued and Submitted
January 10, 2013—Pasadena, California

Filed January 28, 2013

Before: Stephen Reinhardt, Kim McLane Wardlaw,
and Richard A. Paez, Circuit Judges.

Per Curiam Opinion

SUMMARY*

Federal Tort Claims Act

The panel affirmed the district court’s dismissal of an action alleging claims under the Federal Tort Claims Act.

The panel held that the district court correctly concluded that it lacked jurisdiction to entertain appellants’ claims because they fell within the “discretionary function” exception to the United States’ waiver of sovereign immunity in the Federal Tort Claims Act. The panel affirmed the district court’s judgment of dismissal for lack of subject matter jurisdiction, and adopted Parts I through V of the district court’s April 20, 2010 opinion, *Dichter-Mad Family Partners, LLP v. United States*, 707 F. Supp.2d 1016 (C.D. Cal. 2010). The panel also held that the additional allegations made in the Second Amended Complaint were insufficient to overcome the discretionary function exception to the Act’s waiver of sovereign immunity. Finally, the panel held that the district court did not abuse its discretion in denying appellants’ request for additional discovery.

COUNSEL

Richard H. Gordon (argued), Beverly Hills, California and Philip J. Dichter, Malibu, California, for Appellants.

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

Sparkle Sooknanan (argued), Lindsey Powell, Mark B. Stern, and Tony West, United States Department of Justice, Washington, D.C.; and André Birotte, Jr., United States Attorney, Los Angeles, California, for Appellee.

OPINION

PER CURIAM:

After careful de novo review of the record in this appeal, we conclude that the district court correctly concluded that it lacked jurisdiction to entertain Appellants' claims because they fall within the "discretionary function" exception to the United States' waiver of sovereign immunity in the Federal Tort Claims Act. 28 U.S.C. § 2680(a). Thus, we affirm the district court's judgment of dismissal for lack of subject matter jurisdiction and adopt Parts I through V of the district court's comprehensive and well-reasoned April 20, 2010 opinion, *Dichter-Mad Family Partners, LLP v. United States*, 707 F. Supp. 2d 1016 (C.D. Cal. 2010), as our own, and attach it to this opinion as an Appendix.

We further hold, as the district court also concluded in an unpublished order dismissing Appellants' claims with prejudice, that the additional allegations made in the Second Amended Complaint¹ are insufficient to overcome the discretionary function exception to the Federal Tort Claims Act's waiver of sovereign immunity. Virtually all of the newly alleged mandatory duties are not in fact mandatory

¹ The duties alleged in the Second Amended Complaint are taken from the SEC Enforcement Manual, which the district court ordered the government to produce.

directives that would deprive the United States of its discretionary function immunity. *See Terbush v. United States*, 516 F.3d 1125, 1138 (9th Cir. 2008); *Sabow v. United States*, 93 F.3d 1445, 1453 (9th Cir. 1996) (“[T]he presence of a few, isolated provisions cast in mandatory language does not transform an otherwise suggestive set of guidelines into binding agency regulations.”). Those policies that are arguably mandatory lack the causal relationship to the plaintiffs’ alleged injuries required to establish jurisdiction, even under a generous reading of the complaint. “Where, as here, the harm actually flows from the prosecutor’s exercise of discretion, an attempt to recharacterize the action as something else must fail.” *Gen. Dynamics Corp. v. United States*, 139 F.3d 1280, 1286 (9th Cir. 1998).

Finally, the district court did not abuse its discretion in denying Appellants’ request for additional discovery. “As we have explained, ‘broad discretion is vested in the trial court to permit or deny discovery, and its decision to deny discovery will not be disturbed except upon the clearest showing that denial of discovery results in actual and substantial prejudice to the complaining litigant.’” *Hallett v. Morgan*, 296 F.3d 732, 751 (9th Cir. 2002) (alteration omitted) (quoting *Goehring v. Brophy*, 94 F.3d 1294, 1305 (9th Cir. 1996)). A plaintiff seeking discovery must allege “enough fact to raise a reasonable expectation that discovery will reveal” the evidence he seeks. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007); *see also Gager v. United States*, 149 F.3d 918, 922 (9th Cir. 1998) (“It is well-established that the burden is on the party seeking to conduct additional discovery to put forth sufficient facts to show that the evidence sought exists.”) (internal quotation marks and alterations omitted). The district court’s reasoned

finding that the plaintiffs failed to meet this burden was a proper exercise of its discretion. *See Hallett*, 296 F.3d at 751.

AFFIRMED.

APPENDIX

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

DICTER-MAD FAMILY PARTNERS, LLP;)	CV 09-9061 SVW (FMOx)
PHILIP DICHTER; CLAUDIA GVIRTZMAN)	
DICTER; and RICHARD H. GORDON,)	ORDER GRANTING DEFENDANTS'
)	MOTIONS TO DISMISS FOR LACK OF
)	JURISDICTION [6,7]
Plaintiffs,)	
)	
v.)	
)	
UNITED STATES OF AMERICA;)	
SECURITIES EXCHANGE COMMISSION,)	
and Does 1-10,)	
)	
Defendants.)	

I. INTRODUCTION

A. BACKGROUND

Plaintiffs were investors in Bernard Madoff's Ponzi scheme.¹
Plaintiffs are bringing a Federal Tort Claims Act ("FTCA") action

¹ The plaintiffs are:
 -Dichter-Mad Family Partners, LLP (a Florida partnership represented by attorney Philip Dichter, an investor in the partnership),
 -Philip Dichter (who is a lawyer representing himself),
 -Claudia Gvirtzman Dichter (represented by Philip Dichter), and
 -Richard M. Gordon (who is a lawyer representing himself).

1 against the Securities and Exchange Commission ("SEC") and the United
2 States ("Government" or "Defendant"). Plaintiffs assert that the SEC
3 "owes a duty of reasonable due care to all members of the general
4 public including all investors in U.S. financial markets who are
5 foreseeably endangered by its conduct." (Compl. ¶ 163.) Plaintiffs
6 also assert that the SEC's negligent acts and omissions "caused
7 Madoff's scheme to continue, perpetuate, and expand," and that the SEC
8 "fail[ed] to terminate Madoff's Ponzi scheme despite its multiple
9 opportunities to do so." (Compl. ¶ 2; see also Compl. ¶ 164.)
10 Plaintiffs further assert that "Plaintiffs here were among those
11 victimized by Madoff. Plaintiffs made their investments in reliance on
12 Madoff's reputation, clean regulatory record, and the SEC's implied
13 stamp of approval." (Compl. ¶ 8.) Because of the SEC's alleged
14 negligence, Plaintiffs seek to recover their losses from their
15 investments with Madoff.

16 Defendants have brought a pair of Motions to Dismiss, arguing that
17 the Court lacks jurisdiction to hear the claims under the FTCA, 28
18 U.S.C. § 2674 *et seq.* Under the "discretionary function exception" to
19 the FTCA, federal courts are barred from adjudicating tort actions
20 arising out of federal officers' discretionary acts. 28 U.S.C. §
21 2680(a). In brief, officers are only liable if (1) the officers'
22 actions were prescribed by statute, regulation, or policy, or (2) the
23 officers' conduct was not susceptible to analysis on social, economic,
24 or political policy grounds. See United States v. Gaubert, 499 U.S.
25 315, 322 (1991).²

26
27 ²There are, of course, various other requirements and exceptions in the
28 FTCA. This brief summary only relates to the matter at issue here – the
discretionary function exception.

1 The Complaint contains over fifty pages of allegations summarizing
2 the SEC's failure to uncover Madoff's fraud. The Complaint also
3 attaches five exhibits, the most substantial of which is the SEC Office
4 of Inspector General's 450-page *Investigation of Failure of the SEC to*
5 *Uncover Bernard Madoff's Ponzi Scheme - Public Version* [hereinafter
6 "the Report"], which was released in August 2009. (Compl., Ex. A.)³
7 Plaintiffs purport to adopt the "factual allegations or determinations
8 made in the report" by "fully incorporat[ing] by reference" the Report
9 as a part of the Complaint. (Compl. ¶ 1 n.3.) This request is
10 technically impermissible under Fed. R. Civ. P. 10(c), which only
11 permits the incorporation of a legally operable "written instrument"
12 such as a contract, check, letter, or affidavit. See, e.g., Rennie &
13 Laughlin, Inc. v. Chrysler Corp., 242 F.2d 208, 209 & n.209 (9th Cir.
14 1957); see also Wright & Miller, 5A Federal Practice & Procedure § 1327
15 n.1 (3d ed. 2009 update). In contrast, items such as "newspaper
16 articles, commentaries and editorial cartoons" are not properly
17 incorporated into the complaint by reference. Perkins v. Silverstein,
18 939 F.2d 463, 467 n.2 (7th Cir. 1991); see also Wright & Miller, 5A
19 Federal Practice & Procedure § 1327 n.2.

20 That said, Defendants have not objected to Plaintiffs' attempt to
21 incorporate the Report by reference into the Complaint. (See generally
22 Defs.' Motion; Defs.' Reply.) Additionally, Fed. R. Civ. P. 8(e)
23 requires the Court to "construe[] pleadings so as to do justice." In
24 order for the Court to comply with Rule 8(e) and give Plaintiffs the
25 benefit of any plausible inferences contained in the Report (as
26

27 ³This Order refers to the Office of Inspector General's report as "the
28 Report," and pin-citations to the Report are abbreviated as "Ex. A."

1 Plaintiffs repeatedly urged the Court to do, see, e.g. Compl. ¶ 1 n.3,
2 Sur-reply at 5 n.1), the Court has reviewed the full Report and treats
3 it as though it were fully included in Plaintiffs' Complaint. Although
4 this is an unusual procedure, there is clear legal authority permitting
5 the Court to do so: Plaintiffs' Complaint "reference[s]" the Report
6 "extensively," and the factual allegations contained in the Report are
7 "integral to [their] claim." United States v. Ritchie, 342 F.3d 903,
8 908 (9th Cir. 2003) (citations omitted). Thus, it is appropriate in
9 this particular instance to consider the Report as part of Plaintiffs'
10 allegations for purposes of the present Motion to Dismiss.

11 Although the inclusion of the Report results in an unusually long
12 Complaint, the Ninth Circuit has counseled that an overly detailed
13 complaint is acceptable under Fed. R. Civ. P. 8(a) if, for example, it
14 is "organized, [and is] divided into a description of the parties, a
15 chronological factual background, and a presentation of enumerated
16 legal claims, each of which lists the liable Defendants and legal basis
17 therefor." Hearns v. San Bernardino Police Dept., 530 F.3d 1124, 1132
18 (9th Cir. 2008). In the present case, both the Complaint and the
19 Report satisfy these criteria. Accordingly, because the Report is both
20 attached to and incorporated-by-reference into the Complaint, it is
21 properly considered on the Motion to Dismiss. (See also *infra* Part
22 III.A.)

23 Many of Plaintiffs' allegations (including the factual averments
24 contained in the Report) identify decisions that, in hindsight, could
25 have and should have been made differently. Other allegations reveal
26 the SEC's sheer incompetence in regulating Madoff's broker-dealer,
27 market-making, and investment-management operations. What is lacking
28

1 in the present Complaint, however, is any plausible allegation
2 revealing that the SEC violated its clear, non-discretionary duties, or
3 otherwise undertook a course of action that is not potentially
4 susceptible to policy analysis.

5 **B. FACTUAL ALLEGATIONS**

6 The facts of the Madoff fraud need little introduction. A
7 thorough summary of Madoff's operations can be found in the recent
8 decision In re Bernard L. Madoff Inv. Secs. LLC, 424 B.R. 122, 127-32
9 (Bkrtcy. S.D.N.Y. 2010) (order affirming trustee's determination of
10 former investors' net equity).

11 In the present case, Plaintiffs' central allegations are largely
12 drawn from the Inspector General's Report, which Plaintiffs have
13 incorporated by reference into the Complaint. (Compl. ¶ 1 n.3.) The
14 Complaint alleges the following.

15 The first warning sign of Madoff's fraud came in 1992, when
16 Avellino & Bienes, a firm that invested exclusively through Madoff's
17 brokerage, was exposed as a Ponzi scheme. (Compl. ¶¶ 29-40; Ex. A at
18 42-61.) Plaintiffs explain that the SEC's investigators were "woefully
19 inexperienced" in the area of Ponzi schemes (Compl. ¶ 32) and failed to
20 obtain trading records from the Depository Trust Corporation that could
21 have revealed that Madoff's operations were fraudulent. (Compl. ¶¶ 35,
22 37.) Because the SEC was focused on Avellino & Bienes rather than
23 Madoff, the SEC staff failed to make a number of other "common sense"
24 inquiries into Madoff's operations that "should have" been done.
25 (Compl. ¶¶ 34, 37, 39.)

26 The second warning sign came in May 2000, when industry analyst
27 Harry Markopolos provided an eight-page complaint to the Boston SEC
28

1 office. (Compl. ¶¶ 42-46; Ex. A at 61-67.) The complaint provided
2 evidence "questioning the legitimacy of Madoff's reported returns."
3 (Compl. ¶ 42.) Markopolos presented his findings to an unqualified
4 senior staff member (Compl. ¶ 44), and although the staffer stated that
5 he forwarded the matter to the New York office, he did not actually do
6 so. (Compl. ¶ 45.)

7 The third warning sign came in March 2001, when Markopolos
8 submitted a second complaint to the Boston office containing new,
9 simplified information. (Compl. ¶¶ 47-50; Ex. A at 67-74.) This time,
10 the matter was forwarded to New York, but "after just one day" the lead
11 enforcement attorney in New York "rejected it out of hand." (Compl. ¶
12 49.) Although Markopolos's complaint was more detailed than the
13 average complaint, the attorney wrote a short email stating "I don't
14 think we should pursue this matter further." (Compl. ¶¶ 49-50.)⁴

15 The fourth warning sign came in May 2001, when industry
16 publications *MARHedge* and *Barron's* published articles discussing the
17 secrecy of Madoff's operations and the improbability of his
18 consistently strong returns. (Compl. ¶¶ 51-57; Ex. A at 74-77, 80-81,
19 86.) An SEC staff member in the Boston office asked the New York team
20 reviewing Markopolos's complaint if they were interested in reading the
21 articles. (Compl. ¶ 55.) The New York team apparently did not read
22 the articles. (Id.) At the same time, the articles piqued a
23 Washington supervisor's interest. (Compl. ¶ 56.) Although the
24

25
26 ⁴In full, the email stated: "As we discussed, after reviewing the complaint
27 received (via the [Boston office]) from Harry Markopol[os] of Rampart
28 Investments about purported performance claims for funds managed by Bernard
Madoff, and some information about Madoff and others identified in the
complaint, I don't think we should pursue this matter further." (Ex. A at
72.)

1 supervisor wrote a note on the article stating that "[t]his is a great
2 exam[ination] for us!" no further actions were taken in the Washington
3 office. (Compl. ¶ 56; Ex. A at 86.)

4 The first major investigative event came in May 2003, when a hedge
5 fund manager provided a complaint to the SEC's Office of Compliance
6 Inspections and Examinations in Washington D.C. (Compl. ¶¶ 58-81; Ex.
7 A at 77-145.) The fund manager's complaint summarized a number of red
8 flags that suggested that Madoff was running a Ponzi scheme. (Compl. ¶
9 59.) The Investment Management team in Washington, which was more
10 qualified to handle an investigation into a Ponzi scheme, referred the
11 matter to the Washington office's Broker-Dealer team. (Compl. ¶¶ 61-
12 62.) The two teams never conferred on the investigation. (Compl. ¶
13 62.) Compounding this failure to confer, the Broker-Dealer team
14 employed a number of inexperienced staff members at that time. (Compl.
15 ¶¶ 63-64.) One team member explained that "[a]t the time . . . we were
16 expanding rapidly," (Compl. ¶ 63, quoting Ex. A, at 90) and various
17 staff members recalled that they received little-to-no formal training.
18 (Compl. ¶¶ 63-64.)

19 Upon receiving the case, the Washington Broker-Dealer team
20 inexplicably failed to begin its investigation for nine months and
21 failed to log its investigation into the SEC's Super Tracking and
22 Reporting System (STARS), a computer database used to track
23 examinations. (Compl. ¶¶ 65-67; Ex. A at 85 n.54.) This failure to
24 log the investigation was consistent with the SEC's regular practice at
25 the time. (Id.) Once the investigation commenced, the team focused

26 ///

27 ///

1 its attention on potential front-running⁵ - with which it was more
2 familiar - rather than a Ponzi scheme. (Compl. ¶¶ 65-67.) The team
3 created a written plan, but the plan was "too narrowly focused" (Ex. A
4 at 142) and the team did not follow through by obtaining relevant
5 information from third parties. (Compl. ¶ 70.) At one point, the
6 Broker-Dealer team drafted a letter "to the [National Association of
7 Securities Dealers] to confirm Madoff's trading activity," but
8 refrained from sending the letter because, according to one staff
9 member, "it would have been too burdensome and time-consuming for the
10 staff to review the documents that the [National Association of
11 Securities Dealers] would have supplied in response." (Compl. ¶¶ 69-
12 70, paraphrasing Ex. A at 98.) Similarly, "the team failed to consult
13 the Chicago Board Options Exchange," even though Madoff's purported
14 options trades were being processed through it. (Compl. ¶ 74.)
15 Instead of receiving this information from third parties that "would
16 have assisted in independently verifying [Madoff's] trading activity,"
17 the team "rel[ie]d solely on verbal answers" from Madoff, which,
18 according to the Office of the Inspector General's consultants, "is not
19 an appropriate method of examination." (Compl. ¶¶ 70, 72, quoting Ex.
20 A at 111 n.74, 206 n.143.) The team supervisor admitted that it was
21 "asinine" for the team not to obtain a proper audit trail, which
22 Plaintiffs characterize as a "common-sense procedure" in such an
23 investigation. (Compl. ¶ 77, quoting Ex. A at 109.)

24 ///

25
26
27 ⁵ Front-running is the practice in which a "broker execut[es] orders on a
28 security for its own account while taking advantage of advance knowledge of
pending orders from its customers." (Compl. ¶ 66.) See also Black's Law
Dictionary 739 (9th ed. 2009) (defining term in similar manner).

1 The Washington team stopped its investigation in April 2004
2 because SEC supervisors "determined that a new investigation probing
3 mutual funds was more important than following up on Madoff." (Compl.
4 ¶ 78.)⁶ At the end of the investigation, the team failed to produce a
5 final report, which according to the Report was a "critical error" that
6 later led to unnecessary duplication of efforts. (Compl. ¶ 78, quoting
7 Ex. A at 144.)

8 The second major investigation started in the Northeast Regional
9 (New York) Office in April 2004, just as the Washington investigation
10 was being put on indefinite hold. (Compl. ¶¶ 82-109.) The New York
11 investigation was prompted by the SEC's discovery of internal emails
12 from a hedge fund that had invested with Madoff through a feeder fund
13 that invested directly in Madoff's funds. Upon conducting due
14 diligence, the hedge fund had decided to withdraw its investments from
15 the Madoff feeder fund. (Compl. ¶¶ 82-83.) The emails summarized the
16 investor's concerns about Madoff's activities, and essentially tracked
17 the issues raised in the Markopolos reports and the articles that had
18 appeared in *MARHedge* and *Barron's*. (Compl. ¶¶ 83-84.)

19 The New York investigation proceeded in a similar manner as the
20 Washington investigation. (Compl. ¶ 86.) The case was transferred
21 from an Investment Management team to an ill-equipped Broker-Dealer
22 team; the Broker-Dealer team was not even assembled for seven months,
23 and did not begin working for yet another three months; and, once the
24 investigation commenced, the Broker-Dealer team never consulted the
25

26 ⁶ One examiner later wrote that "[i]n early 2004, [the Office of Compliance
27 Inspections and Examinations] made it a priority to examine mutual funds'
28 undisclosed payments to broker-dealers," (Ex. A at 125, quoting July 1, 2009
letter from Lori Richards to Inspector General David Kotz), and contemporary
records confirm this. (Ex. A at 125-26.)

1 Investment Management team for guidance and advice. (Compl. ¶¶ 86,
2 88.) Unlike the team that conducted the Washington investigation, the
3 New York Broker-Dealer team failed to even draft a planning memorandum,
4 let alone follow it. (Compl. ¶ 87.) When conducting the
5 investigation, the team accepted Madoff's assertions at face value,
6 even though they knew or should have known that Madoff was lying - for
7 example, by saying that he was no longer trading options (which was
8 contradicted by readily available records, see Ex. A at 172, 207) and
9 that he was satisfied with foregoing hundreds of millions of dollars in
10 potential management fees and receiving only brokerage commissions
11 instead. (Compl. ¶¶ 90-92.) The team focused its investigation on
12 their own area of expertise (front-running and "cherry-picking"⁷), while
13 ignoring other potential areas of investigation such as looking for a
14 Ponzi scheme. (Compl. ¶¶ 88-89.)⁸ They generally failed to corroborate
15 information with third parties or follow up on red flags such as
16 Madoff's auditor's conflict of interest and obvious inadequacy to audit
17 a complex operation like Madoff's. (Compl. ¶¶ 94-96.)

18 In spite of these failings, the New York investigation came
19 remarkably close to uncovering Madoff's fraud in June 2005. The team
20 conducted a two-to-three month on-site investigation (see Ex. A at 179)

22 ⁷ "[C]herry-picking is generally a scheme in which trades, once they
23 are determined to be favorable, are allocated to a favored account at
the expense of other accounts." (Ex. A at 146 n.92.)

24 ⁸ One of the investigators explained that he interpreted the initial
25 complaint and referral as suggesting that the investigation "focus
26 exclusively on whether Madoff was using his market making capability to
27 cherry pick trades or to front run market making trades for the benefit of
his hedge fund clients." (Ex. A at 167, paraphrasing testimony of John
Nee.) Another team members explained that "he focused on abusive trading
practices rather than the other issues raised in the [referral] e-mail, in
part, because order leakage was a prominent issue at the time of the
28 examination." (Ex. A at 168, paraphrasing testimony of Robert Sollazzo.)

1 and had a formal interview with Madoff in late May (Ex. A at 193-95).
2 Embarrassingly for the SEC, it was during the May meeting that the New
3 York team first learned – from Madoff himself – about the prior
4 Washington investigation. (Compl. ¶¶ 102-04.) Shortly after the
5 interview, the examiners decided that they should contact Madoff’s
6 clients to corroborate his trading activity. (Ex. A at 219-21.) The
7 investigators successfully obtained useful information from one
8 relevant third party (Barclays), but they failed to follow up on it
9 because of a mistaken belief that they could not obtain audit-trail
10 data from Barclays’s foreign affiliates. (Compl. ¶ 101.) Another
11 staffer stated that, to his understanding, SEC had a general policy of
12 not contacting third parties to follow up on leads. (Compl. ¶ 100.)
13 The team also planned on requesting written responses to follow-up on
14 their face-to-face meeting with Madoff, but ultimately failed to do so,
15 even though they had drafted such an inquiry letter. (Compl. ¶ 108;
16 Ex. A at 203-04.)

17 When the New York investigators finally suggested conducting on-
18 site visits of Madoff’s clients, the team supervisor vetoed the
19 suggestion. (Compl. ¶¶ 97-99.) A Washington investigator had
20 explained that he “was hesitant to make trouble for someone so ‘well
21 connected’” (Compl. ¶ 97, quoting Ex. A at 194), and the New York
22 supervisor “expressed a fear that he (and the junior staffers) could be
23 sued as individuals if their inquiries to third parties somehow damaged
24 Madoff’s business.” (Compl. ¶ 98.) Within days of the decision not to
25 visit Madoff’s clients, the New York investigators began drafting their
26 case-closing memorandum, and the case was closed by September 2005.
27 (Compl. ¶ 107.) Madoff himself believed that had the investigators
28

1 | contacted third-party trading partners, account holders, and/or trade-
2 | clearing and -settlement agencies, they would likely have exposed the
3 | fraud. (Ex. A at 206-07.)

4 | Almost immediately after the New York team closed its
5 | investigation, Harry Markopolos provided the Boston office with a third
6 | version of his report on Madoff's alleged fraud, sparking off yet
7 | another investigation in Madoff's operations. (Compl. ¶¶ 110-146.)
8 | Markopolos's report summarized the many warning signs that Madoff was
9 | running a Ponzi scheme, and referred the SEC to a handful of industry
10 | insiders who could corroborate Markopolos's suspicions. (Compl. ¶¶
11 | 111-16.) Markopolos even recommended that the SEC simply compare
12 | Madoff's purported over-the-counter options trading to the publicly-
13 | reported information regarding exchange-based options trading. (Compl.
14 | ¶ 115; see also Ex. C, at 6-7.) Markopolos explained that if Madoff
15 | were truly trading in options, his high-volume trades would have a
16 | visible effect in the market. (Compl. ¶ 115.).

17 | The Boston office referred the matter to the New York office, and
18 | emphasized to the New York staff that the report deserved close
19 | attention. (Compl. ¶ 117.) The New York office, instead of staffing
20 | the matter with experts in Ponzi schemes, placed relatively
21 | inexperienced staff members on the case. (Compl. ¶ 118.) The
22 | investigators failed to treat the matter as a Ponzi scheme
23 | investigation, and generally refused to credit Markopolos's report
24 | because of interpersonal tensions (Compl. ¶¶ 119-20, 122) and a
25 | misguided belief that Markopolos was seeking a reward for uncovering
26 | the fraud. (Compl. ¶ 121.) The team also relied on the earlier New
27 | York team's incorrect assertion that it had in fact investigated the
28 |

1 Ponzi-scheme angle, which deterred the new team from fully following up
2 on Markopolos's suggestions. (Compl. ¶ 123.) Additionally, because
3 the new team had failed to file a "matter under inquiry" report for two
4 months, a new tip – this time from an anonymous investor who stated
5 that he had invested with Madoff but withdrew his money when he began
6 suspecting fraud – was improperly ignored. (Compl. ¶¶ 124-25.)
7 Because the team felt outmatched by the technical aspects of Madoff's
8 operations, they forwarded certain matters to the SEC's Office of
9 Economic Analysis, but due to miscommunications running in both
10 directions, these efforts failed to produce useful insights. (Compl.
11 ¶¶ 128-30.)

12 The unprepared New York investigations team eventually proceeded
13 with its investigation and interviewed Madoff directly. (Compl. ¶¶
14 132-36.) At one point, the interview produced potentially
15 incriminating information – Madoff's account number with the Depository
16 Trust Company – but the investigators failed to properly follow up on
17 the matter. (Compl. ¶¶ 136-37.) When a junior staffer contacted the
18 Depository Trust Company, the staffer failed to recognize the
19 significance of the fact that Madoff held his assets in commingled
20 accounts, and the staffer also failed to ask about the size of the
21 account. (Compl. ¶¶ 138-39; Ex. A at 323-24.) Madoff himself has
22 acknowledged that had the investigators simply asked to see the size of
23 the account, they immediately would have discovered that Madoff's
24 trading positions were nowhere near as large as he had claimed. The
25 staff believed, based on Madoff's representations, that the Depository
26 Trust Company account held over \$2 billion of securities; in fact, the
27 account held only between \$10 and \$30 million. (Ex. A at 332-33.)
28

1 The investigators also failed to recognize the significance of the
2 fact that the National Association of Securities Dealers told them that
3 Madoff had no option positions on a particular date, even though
4 Madoff's purported trading strategy was based on options trades.
5 (Compl. ¶ 140.) Finally, the investigators made, in the Report's
6 description, an "inexplicable decision" not to send a letter to obtain
7 information from Madoff's purported European counterparties. (Compl. ¶
8 141; Ex. A at 371.) The team closed the investigation in June 2006,
9 having overlooked various clear indications of Madoff's fraud. (Compl.
10 ¶¶ 144-47.) The team also failed to follow up on possible charges
11 related to Madoff's various misrepresentations and non-disclosures
12 during the interview and examinations. (See Ex. A at 322-23.)

13 Following that investigation, the SEC received three more tips
14 that might have uncovered the fraud. (Compl. ¶¶ 148-53.) The first
15 was dismissed when Madoff's attorney told the SEC that the tipster was
16 not actually a Madoff client (Compl. ¶ 150); the second was yet another
17 Markopolos warning that was simply ignored because the staff believed
18 that it had fully examined the Ponzi-scheme allegations (Compl. ¶ 151;
19 Ex. A at 354-55); and the third tip (from the former Madoff investor
20 whose earlier complaint had arrived just prior to the opening of the
21 final investigation) was likewise ignored because the investigation was
22 deemed complete. (Compl. ¶¶ 152-53.)

23 More than two years after the closure of the final investigation,
24 Madoff's fraud was exposed. (Compl. ¶¶ 154-55.) The fraud could have
25 been discovered at any number of points in the previous sixteen years
26 had the SEC "performed its everyday, non-discretionary functions with
27 the most basic level of competence." (Compl. ¶ 158.) At various
28

1 points, even "a single action, performed diligently and ably, or even
2 with the most minimal competence, would have exposed the scheme."
3 (Compl. ¶ 159.)
4

5 **II. PRELIMINARY PROCEDURAL ISSUES**
6

7 **A. THE SECURITIES AND EXCHANGE COMMISSION IS NOT A PROPER**
8 **DEFENDANT**

9 The three Dichter Plaintiffs (that is, the Dichter-Mad investment
10 partnership, Philip Dichter, and Claudia G. Dichter) voluntarily
11 dismissed the SEC and the Doe Defendants on January 11, 2010.

12 The SEC brings a separate Motion to Dismiss Plaintiff Gordon's
13 claims against it. [Docket no. 7.] In its one-page motion, the SEC
14 cites clear controlling authority that bars Gordon's claims. See,
15 e.g., FDIC v. Craft, 157 F.3d 697, 706 (9th Cir. 1998) ("The FTCA is
16 the exclusive remedy for tortious conduct by the United States, and it
17 only allows claims against the United States. Although such claims can
18 arise from the acts or omissions of United States agencies (28 U.S.C. §
19 2671), an agency itself cannot be sued under the FTCA."); see also
20 Standifer v. SEC, 542 F. Supp. 2d 1312, 1317 (N.D. Ga. 2008) ("The SEC
21 cannot be sued under the FTCA.")

22 In Gordon's Opposition,⁹ he does not even attempt to argue that his
23

24
25 ⁹ Gordon's "Opposition" brief is 37-pages long, well above the 25-page limit
26 set by this Court. In addition, Gordon did not file his substantive brief
27 with this Court until March 1, which was one week later than the deadline
28 set by this Court's Local Rules. The Court accordingly STRIKES Gordon's
Opposition. However, as the document raises the same issues as are raised
in Plaintiffs' joint Opposition and Sur-Reply (which the Court has
considered despite its procedural irregularities), the Court has addressed
all the issues raised in Gordon's stricken submission.

1 claims against the SEC are viable. Accordingly, the SEC's Motion is
2 GRANTED. Gordon's claims against the SEC are DISMISSED.

3 **B. THE DOE DEFENDANTS ARE PERMISSIBLE**

4 As for the Doe Defendants, Gordon properly points out that the
5 Government does not necessarily have standing to object to their
6 presence. For purposes of this motion, then, the Doe Defendants'
7 liability is linked with that of the United States.

8
9 **III. LEGAL STANDARDS**

10
11 **A. MOTION TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION**

12 In order to comply with the notice pleading standards of Fed. R.
13 Civ. P. 8(a), a plaintiff's complaint "must contain sufficient factual
14 matter, accepted as true, to 'state a claim to relief that is plausible
15 on its face.'" Ashcroft v. Iqbal, __ U.S. __, 129 S.Ct. 1937, 1949
16 (2009) (quoting Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007)).
17 "A claim has facial plausibility when the plaintiff pleads factual
18 content that allows the court to draw the reasonable inference that the
19 defendant is liable for the misconduct alleged." Id. A complaint that
20 offers mere "labels and conclusions" or "a formulaic recitation of the
21 elements of a cause of action will not do." Id.; see also Moss v. U.S.
22 Secret Service, 572 F.3d 962, 969 (9th Cir. 2009) (citing Iqbal, 129
23 S.Ct. at 1951).¹⁰

24
25 ¹⁰Although the present motion is a motion to dismiss for lack of
26 jurisdiction under Fed. R. Civ. 12(b)(1) rather than a motion to dismiss for
27 failure to state a claim under Fed. R. Civ. P. 12(b)(6), motions to dismiss
28 on jurisdictional grounds are governed by the standard pleading rules of
Fed. R. Civ. P. 8(a). See Doe v. Holy See, 557 F.3d 1066, 1074 (9th Cir.
2009) (per curiam) (citing Twombly, 127 S.Ct. at 1964-65), cert. filed (June
25, 2009). In addition, it should be noted that Twombly and Iqbal, while

1 Generally, the Court's analysis is limited to the contents of the
2 complaint. See Schneider v. Cal. Dept. Of Corrections, 151 F.3d 1194,
3 1197 n.1 (9th Cir. 1998) (citations omitted). However, "[w]hen a
4 plaintiff has attached various exhibits to the complaint, those
5 exhibits may be considered in determining whether dismissal [i]s
6 proper." Parks School of Business, Inc. v. Symington, 51 F.3d 1480,
7 1484 (9th Cir. 1995) (citation omitted). Likewise, the Court "may . .
8 . consider certain materials – documents attached to the complaint,
9 documents incorporated by reference in the complaint, or matters of
10 judicial notice – without converting the motion to dismiss into a
11 motion for summary judgment." United States v. Ritchie, 342 F.3d 903,
12 907 (9th Cir. 2003).

13 When a motion to dismiss is granted, ordinarily "any dismissal[,]
14 . . . except one for **lack of jurisdiction**, improper venue, or failure
15 to join a party under Rule 19[,] operates as an adjudication on the
16 merits." Fed. R. Civ. P. 41(b) (emphasis added).

17 **B. FEDERAL TORT CLAIMS ACT**

18 The Federal Tort Claims Act ("FTCA") "gives federal courts
19 jurisdiction over claims against the United States for money damages
20 for injury or loss of property, or personal injury or death caused by

21 _____
22 technically brought under Fed. R. Civ. 12(b)(6), focused their analysis on
23 the notice pleading requirements of Fed. R. Civ. P. 8(a). Twombly and Iqbal
24 therefore state the proper standard for addressing the sufficiency of
25 Plaintiffs' allegations with respect to the Court's subject matter
26 jurisdiction.

27 In the only post-Twombly circuit court to address pleading standards
28 in the FTCA context, the Fifth Circuit cited Twombly as the operative
standard governing a jurisdictional dispute like the present one. Castro v. United States, 560 F.3d 381, 386 (5th Cir. 2009) (citing Lane v. Halliburton, 529 F.3d 548, 557 (5th Cir. 2008)). In addition, the Ninth Circuit has explicitly applied Twombly when analyzing a complaint under the discretionary function exception caselaw, but only had occasion to do so under the Foreign Sovereign Immunities Act, not the FTCA. Doe v. Holy See, 557 F.3d at 1073-74, 1084-85.

1 the negligent or wrongful act or omission of any employee of the
2 Government while acting within the scope of his office or employment,
3 under circumstances where the United States, if a private person, would
4 be liable to the claimant in accordance with the law of the place where
5 the act or omission occurred.'" Sheridan v. United States, 487 U.S.
6 393, 398 (1988) (quoting 28 U.S.C. § 1346(b)). The FTCA provides,
7 however, that the government shall not be liable for "[a]ny claim based
8 upon an act or omission of an employee of the Government . . . based
9 upon the exercise or performance or the failure to exercise or perform
10 a discretionary function or duty on the part of a federal agency or an
11 employee of the Government, whether or not the discretion involved be
12 abused." 28 U.S.C. § 2680(a). This statutory provision, known as the
13 "discretionary function exception," lies at the heart of the present
14 motion. Because the FTCA is jurisdictional, it must be emphasized that
15 the present analysis is focused on jurisdictional considerations rather
16 than the merits of Plaintiffs' Complaint.

17 **C. DISCRETIONARY FUNCTION EXCEPTION**

18 The discretionary function exception provides the government with
19 immunity from suit for "[a]ny claim . . . based upon the exercise or
20 performance of the failure to exercise or perform a discretionary
21 function or duty on the part of a federal agency or employee of the
22 Government, whether or not the discretion involved be abused." 28
23 U.S.C. § 2680(a). "In this way, the discretionary function exception
24 serves to insulate certain governmental decision-making from 'judicial
25 second guessing of legislative and administrative decisions grounded in
26 social, economic, and political policy through the medium of an action
27 in tort.'" Terbush v. United States, 516 F.3d 1125, 1129 (9th Cir.
28

1 2008) (quoting United States v. S.A. Empresa de Viacao Aerea Rio
2 Grandense (Varig Airlines), 467 U.S. 797 (1984)); accord Marbury v.
3 Madison, 5 U.S. (1 Cranch) 137, 170 (1803) ("The province of the court
4 is, solely, to decide on the rights of individuals, not to inquire how
5 the executive, or executive officers, perform duties in which they have
6 discretion.").

7 Whether a given action by a government employee is protected by
8 the discretionary function exception involves a two-part inquiry.

9 First, the court must determine whether the challenged action
10 involves an "element of judgment or choice." United States v. Gaubert,
11 499 U.S. 315, 322 (1991). If "a federal statute, regulation, or policy
12 **specifically** prescribes a course of action for the employee to follow,"
13 then the employee can be held liable for failing to follow the
14 prescribed directive. Id. (emphasis added).

15 Second, "even assuming the challenged conduct involves an element
16 of judgment, it remains to be decided whether that judgment is of the
17 kind that the discretionary function exception was designed to shield."
18 Id. "Because the purpose of this exception is to prevent judicial
19 second-guessing of legislative and administrative decisions grounded in
20 social, economic, and political policy . . . , the exception protects
21 only governmental actions and decisions based on considerations of
22 public policy." Id. at 323.

23 In assessing the second step, it is important to keep in mind that
24 "if a regulation allows the employee discretion, the very existence of
25 the regulation creates a **strong presumption** that a discretionary act
26 authorized by the regulation involves consideration of the same
27 policies which led to the promulgation of the regulations." Id. at 324
28

1 (emphasis added). Thus, “[w]hen established governmental policy, as
2 expressed or implied by statute, regulation, or agency guidelines,
3 allows a Government agent to exercise discretion, it must be presumed
4 that the agent’s acts are grounded in policy when exercising that
5 discretion.” Id. In contrast, if the applicable statute or regulation
6 does not give the employee discretion, no presumption attaches, and the
7 court must determine whether the decisions were “of the kind” that are
8 “susceptible to policy analysis.” Gaubert, 499 U.S. at 323, 325.

9 Where there is no statute, regulation, or policy on point (either
10 conferring discretion or limiting discretion), the relevant question is
11 not whether the decision was the result of an **actual** policy-based
12 decision-making process. As the Ninth Circuit has repeatedly
13 explained, “we do not need actual evidence that policy-weighting was
14 undertaken.” Terbush, 516 F.3d at 1136 n.5 (citing Gaubert, 499 U.S.
15 at 324-25). Instead, “[t]he focus of the inquiry is . . . on the
16 nature of the actions taken and on whether they are **susceptible** to
17 policy analysis.” See Gaubert, 499 U.S. at 325 (emphasis added); see
18 also GATX/Airlog Co., 286 F.3d at 1178 (“[T]he question is not whether
19 policy factors necessary for a finding of immunity were **in fact** taken
20 into consideration, but merely whether such a decision is **susceptible**
21 to policy analysis.”); Nurse v. United States, 226 F.3d 996, 1001 (9th
22 Cir. 2000) (“the challenged decision need not actually be grounded in
23 policy considerations so long as it is, by its nature, susceptible to a
24 policy analysis.”); Childers v. United States, 40 F.3d 973, 974 n.1
25 (9th Cir. 1994) (“The application of the exception does not depend,
26 however, on whether federal officials actually took public policy
27 considerations into account. All that is required is that the
28

1 applicable statute or regulation gave the government agent discretion
2 to take policy goals into account."); Lesoeur v. United States, 21 F.3d
3 965, 969 (9th Cir. 1994) ("[Appellants] argue that the discretionary
4 function exception cannot apply in the absence of a 'conscious
5 decision.' The statute is not so limited. . . . The language is
6 directed at the nature of the conduct, and does not require an analysis
7 of the decision-making process.") (quoting In re Consol. United States
8 Atmos. Testing Litig., 820 F.2d 982, 988-89 (9th Cir. 1987)).

9 The Ninth Circuit has noted that "the distinction between
10 protected and unprotected decisions can be difficult to apprehend, but
11 this is the result of the nature of government actions - they fall
12 'along a spectrum, ranging from those totally divorced from the sphere
13 of policy analysis, such as driving a car, to those fully grounded in
14 regulatory policy, such as the regulation and oversight of a bank.'" "
15 Soldano v. United States, 453 F.3d 1140, 1145 (9th Cir. 2006) (quoting
16 Whisnant v. United States, 400 F.3d 1177, 1181 (9th Cir. 2005)). This
17 distinction is drawn in part from the Supreme Court's discussion in
18 Gaubert, in which the Court explained:

19 There are obviously discretionary acts performed by a Government
20 agent that are within the scope of his employment but not within
21 the discretionary function exception because these acts cannot be
22 said to be based on the purposes that the regulatory regime seeks
23 to accomplish. If one of the officials involved in this case
24 drove an automobile on a mission connected with his official
25 duties and negligently collided with another car, the exception
26 would not apply. Although driving requires the constant exercise
27
28

1 of discretion, the official's decisions in exercising that
2 discretion can hardly be said to be grounded in regulatory policy.
3 Gaubert, 499 U.S. at 325 n.7.

4 In addition to these general principles, it should also be noted
5 that the courts have rejected "a rigid dichotomy between 'planning' and
6 'operational' decisions and activities." Terbush, 516 U.S. at 1130
7 (citing Gaubert, 499 U.S. at 324). The courts have likewise rejected
8 the argument that the government is *per se* immune when conducting
9 "uniquely governmental functions," as such an analysis would "push the
10 courts into the 'non-governmental'-'governmental' quagmire that has
11 long plagued the law of municipal corporations." Indian Towing Co. v.
12 United States, 350 U.S. 61, 64 (1955); see also United States v. Olson,
13 546 U.S. 43, 46 (2005) (reaffirming Indian Towing).

14 **D. PROCEDURAL CONSIDERATIONS RELATING TO THE DISCRETIONARY**
15 **FUNCTION EXCEPTION**

16 In deciding whether to grant Defendant's Motion to Dismiss for
17 lack of subject matter jurisdiction, the Court "must accept as true the
18 factual allegations in the complaint." Terbush v. United States, 516
19 F.3d 1125, 1128 (9th Cir. 2008) (citing GATX/Airlog Co. v. United
20 States, 286 F.3d 1168, 1173 (9th Cir. 2002)). "The United States bears
21 the burden of proving the applicability of the discretionary function
22 exception." Id. (citing Prescott v. United States, 973 F.2d 696, 702
23 (9th Cir. 1992)). The government must prove that **each** of the allegedly
24 wrongful acts, by **each** allegedly negligent actor, is covered by the
25 discretionary function exception. GATX/Airlog, 286 F.3d at 1174
26 ("[W]hen determining whether the discretionary function exception is
27 applicable, 'the proper question to ask is not whether the Government
28

1 as a whole had discretion at any point, but whether its allegedly
2 negligent agents did in each instance.'") (citing In re Glacier Bay, 71
3 F.3d 1447, 1451 (9th Cir. 1995)) (alterations omitted). In examining
4 each of the government's particular acts, "the question of **how** the
5 government is alleged to have been negligent is critical." Whisnant v.
6 United States, 400 F.3d 1177, 1185 (9th Cir. 2005) (emphasis added)
7 (citing Glacier Bay, 71 F.3d at 1451). The central question is
8 whether, "at this stage of the case" – and under the standard of proof
9 applicable at this stage – "the government has [or has] not established
10 that choices exercised by government officials involved policy
11 judgments." Prescott, 973 F.2d at 703.

12 These considerations can be summarized succinctly by reference to
13 the two-step analysis set forth in Gaubert, 499 U.S. at 322-25. The
14 government can meet its initial burden in one of two ways, and the
15 plaintiffs can respond to each showing in one of two ways.

16 First, the government may show that a statute, regulation or
17 policy confers discretion on the government actor; this gives rise to a
18 "strong presumption" that the alleged harmful act was guided by policy
19 judgment. Id. at 324. Second, the government may show that the
20 actor's course of action was "of the kind" that is "susceptible to
21 policy analysis." Id. at 323, 325. Either of these showings will
22 satisfy the government's "burden of proving application of the
23 discretionary function exception." Blackburn v. United States, 100
24 F.3d 1426, 1436 (9th Cir. 1996).

25 "[O]nce the Government met its burden, . . . the party opposing
26 [the application of the discretionary function exception] ha[s] to
27 present sufficient evidence to withstand dismissal" for lack of
28

1 jurisdiction. Id. Under Gaubert, the plaintiffs may meet their the
2 burden by showing either (1) that there are mandatory rules prescribing
3 the actor's course of action, or (2) that the actor's course of action
4 was **not** "of the kind" that is "susceptible to policy analysis."
5 Gaubert, 499 U.S. at 323-25.

6 **E. ILLUSTRATIVE CASELAW**

7 As explained by a leading treatise, "cases under the [Federal Tort
8 Claims] Act can be roughly grouped into there categories: (1) claims
9 based upon [non-regulatory] determinations or decisions or other acts
10 of choice or judgment of government officials and administrators; (2)
11 claims based upon the regulatory activities of regulatory agencies or
12 officials; and (3) claims arising from the design or execution of
13 public works and other authorized governmental programs." Lester S.
14 Jayson & Robert C. Longstreth, 2 Handling Federal Tort Claims, §
15 12.05[1] (2009 update).

16 "Whatever else the discretionary function exception may include, .
17 . . it plainly was intended 'to encompass the discretionary acts of the
18 Government acting in its role as regulator of the conduct of private
19 individuals.'" Jayson & Longstreth, Federal Tort Claims, § 12.07
20 (quoting United States v. Varig Airlines, 467 U.S. 797, 813-14 (1984)).
21 That is not to say that regulatory actions enjoy blanket immunity: the
22 "uniquely government functions" approach was rejected by the Supreme
23 Court over half-a-century ago. See Indian Towing, 350 U.S. at 64. But
24 at the very least, it appears from the caselaw and secondary
25 authorities that regulatory actions are more likely to be deemed
26 "discretionary functions" than non-regulatory actions are.

27 ///
28

1 A leading case involving government regulators is United States v.
2 Gaubert, 499 U.S. 315 (1991). In that case, the plaintiff alleged that
3 the Federal Home Loan Bank Board and the Federal Home Loan Bank Dallas
4 branch "had been negligent in carrying out their supervisory
5 activities" following their take-over of a failing Texas savings-and-
6 loan. Id. at 318. The plaintiff, who was the chairman and largest
7 shareholder of the thrift, sought to recover the lost value of his
8 shares and the value of his personal guarantee of the corporation's
9 debts, amounting to \$100 million in total. Id. at 319-20. In
10 particular, the plaintiff alleged that the Federal Home Loan Bank
11 Dallas branch had pressured the failed thrift's sitting officers and
12 directors to resign and then recommended their replacements. Id. at
13 319. The Dallas branch then became significantly involved in the
14 thrift's day-to-day operations. Id. at 319-20. The plaintiff's
15 allegations centered on the "alleged negligence of federal officials in
16 selecting the new officers and directors and in participating in the
17 day-to-day management of" the thrift. Id. at 320.

18 The Supreme Court, after restating the basic two-part test for the
19 discretionary function exception, held that "[d]ay-to-day management of
20 banking affairs, like the management of other businesses, regularly
21 requires judgment as to which of a range of permissible courses is the
22 wisest." Id. at 325. In this regard, the Court rejected the proposed
23 distinction between "policymaking" and "operational" functions. Id.
24 In order to determine whether the alleged acts were discretionary or
25 not, the Court reviewed the complaint's allegations of the government's
26 involvement in the thrift's day-to-day affairs. These allegations
27 focused on the government's involvement in day-to-day management
28

1 decisions, hiring and salary decisions, operational matters, financial
2 matters, asset management, and legal affairs. Id. at 327-28. The
3 government became involved in strategic planning, for example by
4 recommending that the thrift change from being state-chartered to
5 becoming federally-chartered, and by giving advice regarding a
6 potential bankruptcy filing. Id. at 328.

7 Ultimately, the Court rejected the plaintiff's argument "that the
8 challenged actions fall outside the discretionary function exception
9 because they involved the mere application of technical skills and
10 business expertise." Id. at 331. The Court explained that the day-to-
11 day operations of a bank require more than mere "mathematical
12 calculations" that "involve no choice or judgment in carrying out the
13 calculations." Id. Importantly, the Court also noted that "neither
14 party has identified **formal** regulations governing the conduct in
15 question." Id. at 329 (emphasis added). The Court identified broad
16 statutory grants of discretion to the Federal Home Loan Bank to engage
17 in formal supervisory actions, and found no prohibition on the agency's
18 use of less formal supervisory tools. Id. The Court also identified a
19 formal policy statement from the government in which the agency
20 explained its policy "that supervisory actions must be tailored to each
21 case," ranging from "informal supervisory guidance and oversight," to
22 implementation of a "supervisory agreement," and, in the most
23 problematic cases, an immediate "cease-and-desist order." Id. at 330-
24 31 (quoting FHLBB Resolution No. 82-381 (May 26, 1982)).

25 Notably, the Court approvingly quoted from the lower court's
26 explanation that the agency undertook its day-to-day role in an effort
27 to further "social, economic, or political policies":
28

1 First, they sought to protect the solvency of the savings and loan
2 industry at large, and maintain the public's confidence in that
3 industry. Second, they sought to preserve the assets of [the
4 thrift] for the benefit of depositors and shareholders, of which
5 [plaintiff] was one.

6 Id. at 332 (quoting 885 F.2d 1284, 1290 (5th Cir. 1989)). In this
7 regard, the Supreme Court highlighted the fact that "[t]here are no
8 allegations that the regulators gave anything other than the kind of
9 advice that was within the purview of the policies behind the
10 statutes." Id. at 333. For example, the plaintiff admitted "the
11 regulators replaced [the thrift's] management in order to protect the
12 [federal savings and loan insurance corporation's] insurance fund."
13 Id. at 332.

14 "In the end," the Court concluded, "Gaubert's amended complaint
15 alleges nothing more than negligence on the part of the regulators."
16 Id. at 334. The Court explained that even day-to-day regulatory
17 decisions were protected by the discretionary function exception: "If
18 the routine or frequent nature of a decision were sufficient to remove
19 an otherwise discretionary act from the scope of the exception, then
20 countless policy-based decisions by regulators exercising day-to-day
21 supervisory authority would be actionable. This is not the rule of our
22 cases." Id.

23 Gaubert, then, is a guidepost for two reasons: one, because it is
24 the most recent Supreme Court authority in this area, and two, because
25 it involved a roughly analogous factual scenario – the conduct of
26 financial regulators in their day-to-day regulatory activities.
27 (Additional cases that specifically discuss the SEC are discussed
28

1 *infra.*) It is worth noting, then, that Gaubert's reasoning weighs
2 heavily in favor of Defendant's position.

3 A pair of other cases are worth discussing at length. These cases
4 set forth principles that have guided the Ninth Circuit's analysis
5 where cases involve a combination of discretionary and non-
6 discretionary duties.

7 In Glacier Bay, the Ninth Circuit held that hydrographers for the
8 National Oceanic and Atmospheric Administration could be sued for their
9 non-discretionary actions made while preparing nautical charts. 71
10 F.3d at 1452-54. The government had argued that its supervising
11 hydrographers retained discretion when reviewing and approving the
12 charts, and that this final level of discretion immunized all of the
13 allegedly negligent conduct during the oceanic surveys and drafting of
14 the charts. Id. at 1451. The court explained that the final review
15 was indeed discretionary, because the supervisors had to decide whether
16 the survey was sufficiently accurate and whether the social, economic,
17 and political benefits of conducting further surveys outweighed the
18 costs of doing so. Id. at 1454. However, the court also determined
19 that the discretionary final review could not insulate the surveying
20 staff's negligent acts that violated the surveyors' mandatory duties.
21 Id. at 1451. Instead, the court explained that the relevant question
22 is whether "each person taking an allegedly negligent action had
23 discretion," not whether "the Government as a whole had discretion at
24 any point." Id.¹¹

25 _____
26 ¹¹The court also noted, however, that the presence of a discretionary final
27 review might affect the merits of the claim because the plaintiff would be
28 unable to show that the negligent acts proximately caused the plaintiff's
harm. Id. (citing Routh v. United States, 941 F.2d 853, 855 (9th Cir.
1991).)

1 The court then engaged in a close analysis of the surveyors'
2 actions to determine if they violated any non-discretionary duties.
3 Id. at 1452-54. To find these mandatory duties, the court looked to
4 "the Department of Commerce's 'Hydrographic Manual' and [] the 1964 and
5 1975 Project Instructions specifically drafted for the two surveys [at
6 issue]." Id. at 1452. The court noted that, contrary to the
7 government's assertion, such internal guidelines were in fact "binding
8 for purposes of the discretionary function inquiry." Id. at 1452 n.1.
9 The court found that the Hydrographic Manual and Project Instructions
10 established a number of mandatory procedures for conducting oceanic
11 surveys. Id. at 1451-52. Much of the "discretion" available to the
12 surveyors involved purely scientific judgments, not judgments based on
13 "economic, political and social policy" that would be shielded from
14 scrutiny under the FTCA. Id. at 1453. Notably, the court contrasted
15 the 1964 survey instructions with the 1975 survey instructions and
16 found that the former contained mandatory language -- "[a]ll
17 indications of shoals **shall** be thoroughly investigated" -- whereas the
18 latter did not contain such language, and instead stated that surveys
19 "should be guided by [27 different] considerations . . . and [the
20 surveyor's] past experience in similar areas." Id. at 1453 (quoting
21 Hydrographic Manual and 1964 Survey Instructions). Accordingly, the
22 earlier 1964 survey was deemed non-discretionary, whereas the 1975
23 survey -- requiring surveyors to carefully balance 27 different
24 considerations -- was discretionary. Id.

25 Three years later, the Ninth Circuit clarified its holding in
26 Glacier Bay, explaining that in some instances, an underlying violation
27 of a mandatory duty will be immune from suit if another government
28

1 agent's own exercise of discretion intervened prior to the plaintiff's
2 injury. The court explained that the discretionary function exception
3 applies whenever a "robust exercise of discretion intervenes between an
4 alleged government wrongdoer and the harm suffered by a plaintiff."
5 General Dynamics Corp. v. United States, 139 F.3d 1280, 1285 (9th Cir.
6 1998). The court proceeded to distinguish the case at hand from
7 Glacier Bay. The plaintiff in General Dynamics alleged that government
8 auditors had negligently performed an audit that led prosecutors to
9 indict the plaintiff for defrauding the United States, a charge which
10 the plaintiff successfully defended. Id. at 1282. The court held that
11 the plaintiff, by attempting to recover for the auditors' professional
12 negligence rather than the prosecutors' clearly discretionary decision
13 to prosecute, was improperly attempting to plead around the
14 discretionary function exception. Id. at 1283-84. The court refused
15 to "accord amaranthine obeisance to a plaintiff's designation of
16 targeted employees" when, in sum and substance, the complaint was
17 alleging prosecutorial misconduct. Id. at 1283.

18 The General Dynamics court distinguished Glacier Bay by
19 emphasizing that the central focus is the **nature** of the allegedly
20 **harmful act**. Id. at 1284-85. Obviously, "many actions within an
21 agency pass through the hands of somebody with some discretion at some
22 stage"; the mere presence of discretion at one stage in the process
23 does not automatically immunize the non-discretionary negligent conduct
24 that precedes. Id. at 1284. Accordingly, when an oceanic chart is
25 negligently investigated and drafted in violation of mandatory rules,
26 the presence of a discretionary final review does not immunize the
27 negligent investigations and drafting. Id. In this regard, the court
28

1 noted that Glacier Bay involved a "tight coupling between
2 hydrographers, reviewers, charts, and results." Id. at 1284.

3 But when an actor with "broad based discretion" such as the
4 prosecutor in General Dynamics undertakes "a totally separate exercise
5 of discretion" that is independent of the underlying negligent act, all
6 of the government's acts are immunized – including the earlier actions
7 that may have violated mandatory duties. Id. at 1285. The court
8 explained that prosecutors have "access to a great deal of information
9 beyond that submitted by any one agency" such as the negligent
10 auditors. Because "the prosecutors could have had even more
11 information if they had chosen to pursue it," the prosecutor's decision
12 to prosecute the plaintiff was a sufficiently "robust exercise of
13 discretion" to trigger application of the discretionary function
14 exception. Id. As a result, all of government's negligent acts were
15 immunized – even the ones that violated non-discretionary auditing
16 principles.

17 Although they are factually distinguishable from the present case,
18 two out-of-circuit decisions are also worth noting in order to show
19 that the reasoning in General Dynamics has been adopted in other
20 circuits.¹² In Sloan v. United States Dept. of Housing and Urban
21 Development, 236 F.3d 756 (D.C. Cir. 2001), a contractor sued the
22 Department of Housing and Urban Development under the FTCA for
23 negligently conducting an audit of his construction site and for
24 suspending him from government contract work based on the erroneous
25 audit. 236 F.3d at 758-59. On appeal from the district court's
26

27 ¹² The summaries of these cases are drawn from Jerome Stevens Pharma., Inc.
28 v. Food & Drug Admin., 402 F.3d 1249, 1254-55 (D.C. Cir. 2005).

1 dismissal of the complaint for lack of subject matter jurisdiction, the
2 contractor contended that while the suspension of his government
3 contract work was a discretionary function, the audit was not a
4 discretionary function because it was governed by standards of
5 professional practice. Id. at 761. The court rejected that
6 contention, holding that there was "no meaningful way in which the
7 allegedly negligent investigatory acts could be considered apart from
8 the totality of the prosecution." Id. (quoting Gray v. Bell, 712 F.2d
9 490, 516 (D.C. Cir. 1983)) (internal quotation marks omitted). The
10 court noted that "[t]he complaint does not allege any damages arising
11 from the investigation itself, but only harm caused by the suspension
12 to which it assertedly led." Id. at 762.

13 In Fisher Bros. Sales, Inc. v United States, 46 F.3d 279 (3d Cir.
14 1995) (en banc), Chilean fruit growers sued the Food and Drug
15 Administration under the FTCA for banning the importation of Chilean
16 fruit based on a negligently conducted laboratory test concluding that
17 the fruit contained cyanide. 46 F.3d at 282-83. Recognizing that the
18 Commissioner's decision to ban the fruit was a discretionary function,
19 the fruit growers alleged injury "based upon" the negligence of the
20 laboratory technicians, who were bound by the agency's Regulatory
21 Procedures Manual. Id. at 286. The Third Circuit rejected this
22 characterization of the claim, reasoning that "[t]he reality here is
23 that the injuries of which the plaintiffs complain were caused by the
24 Commissioner's decisions and, as a matter of law, their claims are
25 therefore 'based upon' those decisions." Id. The court concluded that
26 "a claim must be 'based upon' the exercise of a discretionary function
27 whenever the immediate cause of the plaintiff's injury is a decision
28

1 | which is susceptible of policy analysis and which is made by an
2 | official legally authorized to make it." Id. at 282.

3 | **F. UNDERLYING POLICIES OF THE DISCRETIONARY FUNCTION EXCEPTION**

4 | Before analyzing the parties' specific arguments, it is also
5 | helpful to explain the policies that animate the discretionary function
6 | exception. As summarized succinctly in Gray v. Bell, 712 F.2d 490
7 | (D.C. Cir. 1983), *cert. denied*, 465 U.S. 1100 (1984):

8 | The modern policy basis justifying sovereign immunity from suit
9 | has three principal themes. First, and most important, under
10 | traditional principles of **separation of powers**, courts should
11 | refrain from reviewing or judging the propriety of the
12 | policymaking acts of coordinate branches. Second, consistent with
13 | the related doctrine of official immunity, courts should not
14 | subject the sovereign to liability where doing so would inhibit
15 | **vigorous decisionmaking by government policymakers**. Third, in the
16 | interest of **preserving public revenues and property**, courts should
17 | be wary of creating huge and unpredictable governmental
18 | liabilities by exposing the sovereign to damage claims for broad
19 | policy decisions that necessarily impact large numbers of people.
20 | Framed in different fashions, each of these themes appears again
21 | and again, alone or in combination, as a modern justification for
22 | retaining a form of immunity, under the general rationale that
23 | courts should not "interfere" with government operations and
24 | policymaking.

25 | Id. at 511 (emphasis added, internal footnotes omitted).

26 | ///

27 | ///

28 |

1 Notably absent from this rationale is any mention of "fairness."
2 As explained in National Un. Fire Ins. v. United States, 115 F.3d 1415
3 (9th Cir. 1997):

4 Private actors generally must pay for the harm they do by
5 carelessness. The government's power to tax enables it, better
6 than any private actor, to perform its conduct with reasonable
7 care for the safety of persons and property, and to spread the
8 cost over all the beneficiaries if its conduct negligently causes
9 harm. Fairness might seem to suggest that the government should
10 be liable more broadly than private actors. But at its root, the
11 discretionary function exception is about power, not fairness.

12 Id. at 1422.

13 As a result of these underlying policies and principles,
14 Plaintiffs are misguided when they argue that "there is no oversight at
15 all available to the taxpaying citizens, as well as the nation, to
16 insure that the SEC does its job." (Opp. at 15.) This broad policy
17 argument is unavailing.

18 19 **IV. ANALYSIS AND DISCUSSION**

20 21 **A. RELEVANT LEGISLATIVE HISTORY**

22 It is often remarked that Congressional intent is particularly
23 relevant to the Federal Tort Claims Act because "no action lies against
24 the United States unless the legislature has authorized it." E.g.,
25 Dalehite v. United States, 346 U.S. 15, 30 (1953) (collecting cases).
26 As a result, "the basic inquiry concerning the application of the
27 discretionary function exception is whether the challenged acts of a
28

1 Government employee - whatever his or her rank - are of the nature and
2 quality that **Congress intended** to shield from tort liability." United
3 States v. S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines),
4 467 U.S. 797, 813-814 (1984) (emphasis added).

5 It is notable, then, that Congress, when drafting and debating the
6 Federal Tort Claims Act, repeatedly and explicitly suggested that the
7 discretionary function exception was intended to apply to the SEC. See
8 Dalehite v. United States, 346 U.S. 15, 29 & n.21(1953) (noting that
9 this particular "paragraph [] appears time and again" in the
10 legislative history). Congress explained that the discretionary
11 function exception was:

12 designed to preclude application of the bill to a claim against a
13 regulatory agency, such as the Federal Trade Commission or the
14 Securities and Exchange Commission, based upon an alleged abuse of
15 discretionary authority by an officer or employee, whether or not
16 negligence is alleged to have been involved. To take another
17 example, claims based upon an allegedly negligent exercise by the
18 Treasury Department of the blacklisting or freezing powers are
19 also intended to be excepted. The bill is not intended to
20 authorize a suit for damages to test the validity of or provide a
21 remedy on account of such discretionary acts even though
22 negligently performed and involving an abuse of discretion.

23 Dalehite, 346 U.S. at 29 n. 21 (quoting H.R.Rep.No. 2245, 77th Cong.,
24 2d Sess., p. 10; S.Rep.No. 1196, 77th Cong., 2d Sess., p. 7;
25 H.R.Rep.No. 1287, 79th Cong., 1st Sess., pp. 5-6; Hearings before
26 H.Com. on Judiciary on H.R. 5373 and H.R. 6463, 77th Cong., 2d Sess.,
27
28

1 p. 33); see also Defs.' Mot. at 10 & n.29 (quoting House Rep. 79-1287,
2 at 5-6).

3 **B. THE GOVERNMENT HAS SATISFIED ITS THRESHOLD BURDEN BY**
4 **IDENTIFYING STATUTES, REGULATIONS, AND CASES DISCUSSING THE**
5 **SEC'S GENERAL POWERS AND DUTIES**

6 In its Motion, the Government sets forth a number of general,
7 broad principles governing the SEC's duties and functions. These legal
8 assertions establish that the alleged wrongs were done in the course of
9 the SEC's exercise of its discretion, both in terms of conducting its
10 investigations and deciding whether or not to bring enforcement
11 proceedings. These basic conclusions are supported by statutes,
12 regulations, and caselaw. Defendant has therefore satisfied its
13 threshold burden under Gaubert of establishing that the relevant
14 statutes and regulations "allow[] the employee[s] discretion."
15 Gaubert, 499 U.S. at 323. Accordingly, there is "a **strong presumption**"
16 that the alleged acts were "based on considerations of public policy,"
17 and Plaintiffs bear the burden of rebutting this presumption. Id.

18 This section discusses the Government's threshold showing that its
19 actions were discretionary and are presumed to be susceptible to policy
20 analysis. The following section discusses Plaintiffs' attempt to rebut
21 this strong presumption.

22 **1. SEC's Investigative Powers**

23 Section 21 of the Securities and Exchange Act of 1934, codified at
24 15 U.S.C. § 78u, establishes the SEC's investigatory powers. The
25 statute explicitly provides discretion to the SEC:

26 The Commission **may, in its discretion**, make such investigations **as**
27 **it deems necessary** to determine whether any person has violated,
28

1 is violating, or is about to violate any provision of this
2 chapter, [or] the rules or regulations thereunder, . . . **and may**
3 require or permit any person to file with it a statement in
4 writing, under oath or otherwise as the Commission shall
5 determine, as to all the facts and circumstances concerning the
6 matter to be investigated. The Commission is authorized **in its**
7 **discretion**, . . . to investigate any facts, conditions, practices,
8 or matters which **it may deem** necessary or proper to aid in the
9 enforcement of such provisions. . . .

10 15 U.S.C. § 78u(a)(1) (emphasis added).

11 Little discussion is necessary. The statute repeatedly uses
12 permissive language rather than mandatory language. The SEC has
13 discretion to decide both the **timing** of when it "make[s] such
14 investigations," and the **manner and scope** of how to "investigate any
15 facts, conditions, practices, or matters," whether through "a statement
16 in writing, under oath **or otherwise**." Id. (emphasis added). All of
17 these decisions are framed in permissive language ("[t]he Commission
18 **may** . . .") and the SEC is permitted to proceed "as it deems
19 necessary." Id. In other words, the statute is discretionary – the
20 SEC retains discretion over **when** and **how** to conduct its investigations.
21 This leads to a strong presumption that the SEC's actions were
22 discretionary. Gaubert, 499 U.S. at 324; see also Vickers v. United
23 States, 228 F.3d 944, 951 (9th Cir. 2000) ("[T]he discretionary
24 function exception protects agency decisions concerning the scope and
25 manner in which it conducts an investigation so long as the agency does
26 not violate a mandatory directive.").

1 The SEC's own regulations are similarly discretionary. As
2 explained in the SEC's formal policies regarding Enforcement
3 Activities, as summarized in 17 C.F.R. § 202.5:

4 Where, from complaints received from members of the public,
5 communications from Federal or State agencies, examination of
6 filings made with the Commission, or otherwise, it appears that
7 there may be violation of the acts administered by the Commission
8 or the rules or regulations thereunder, a **preliminary**
9 **investigation** is **generally** made. In such preliminary
10 investigation no process is issued or testimony compelled. The
11 Commission **may, in its discretion**, make such formal investigations
12 and authorize the use of process **as it deems necessary** to
13 determine whether any person has violated, is violating, or is
14 about to violate any provision of the federal securities laws or
15 the rules of a self-regulatory organization of which the person is
16 a member or participant. . . .

17 17 C.F.R. § 202.5(a) (emphasis added). This regulation does not
18 **require** the SEC to conduct its investigations in any particular manner;
19 rather, the agency retains broad discretion to decide how to conduct
20 its investigations.

21 In light of this statutory and regulatory language, the courts
22 have unanimously rejected challenges to the SEC's use of its
23 investigatory powers. In a pre-FTCA case, Justice Vinson, then a
24 member of the District of Columbia Court of Appeals, wrote an opinion
25 that, inter alia, granted official immunity to members of the SEC for
26 their investigatory activities. Jones v. Kennedy, 121 F.2d 40, 43-44
27 (D.C. Cir. 1941). In a terse discussion, the court explained:
28

1 the **carrying out of investigations** and the turning over of
2 evidence to the Attorney General for presentation to a grand jury
3 come under the authorized duties of the Commission. And likewise,
4 plaintiff has not met, in these allegations, the task of showing
5 acts which fall outside of the [SEC's] immunity.

6 Id. at 43-44 (internal footnote omitted) (emphasis added) (citing 15
7 U.S.C. §§ 77h(e), 77s(c), 77t(b)).

8 Numerous subsequent courts have held that the SEC is immune from
9 liability for its investigative actions. In Schmidt v. United States,
10 198 F.2d 32 (7th Cir. 1952), the court applied the discretionary
11 function exception to bar a claim that the SEC was investigating a
12 corporation and publicizing its investigation for the improper purpose
13 of destroying the company. Id. at 33, 36. The court explained that
14 the SEC's decision to institute an investigation and conduct it in a
15 particular manner "was . . . clearly within the scope of its
16 discretionary authority" under the 1934 Exchange Act. Id. at 36.
17 Nothing more was said, and nothing more needed to be said. The point
18 was – and remains to this day – "perfectly clear [] under the terms of
19 the applicable statutes." Id.

20 The same point has been stated in subsequent cases including
21 Sprecher v. Von Stein, 772 F.2d 16, 18 (2d Cir. 1985), and other cases
22 discussed *infra*, subsection 3.

23 2. SEC's Enforcement Powers

24 The SEC likewise has discretion regarding the use of its
25 enforcement powers. Under 15 U.S.C. § 78u(d)(1), the SEC has
26 discretion over decisions to seek an injunction against ongoing
27 violations of the Exchange Act:
28

1 Whenever it shall appear to the Commission that any person is
2 engaged or is about to engage in acts or practices constituting a
3 violation of any provision of this chapter [or] the rules or
4 regulations thereunder, . . . it **may in its discretion bring an**
5 **action** in the proper district court of the United States . . . to
6 enjoin such acts or practices. . . .

7 15 U.S.C. § 78u(d)(1) (emphasis added).

8 The SEC retains similar discretion regarding whether to seek
9 monetary relief or other injunctive relief. See § 78u(d)(3) ("the
10 Commission **may** bring an action in a United States district court to
11 seek . . . a civil penalty to be paid by the person who committed such
12 violation.") (emphasis added); § 78u(d)(5) ("the Commission **may** seek .
13 . . any equitable relief that **may be appropriate or necessary** for the
14 benefit of investors.") (emphasis added).

15 The regulations are similarly discretionary. Again under 17
16 C.F.R. § 202.5:

17 After investigation or otherwise **the Commission may in its**
18 **discretion** take one or more of the following actions: Institution
19 of administrative proceedings looking to the imposition of
20 remedial sanctions, initiation of injunctive proceedings in the
21 courts, and, in the case of a willful violation, reference of the
22 matter to the Department of Justice for criminal prosecution. The
23 Commission **may also, on some occasions**, refer the matter to, or
24 grant requests for access to its files made by, domestic and
25 foreign governmental authorities or foreign securities
26 authorities, self-regulatory organizations such as stock exchanges
27
28

1 or the National Association of Securities Dealers, Inc., and other
2 persons or entities.

3 17 C.F.R. § 202.5 (emphasis added).

4 Again, the courts are unanimous in holding that these statutory
5 powers are discretionary. In SEC v. Research Automation Corp., 521
6 F.2d 585, 590 (2d Cir. 1975), the court summarily dismissed a
7 defendant's FTCA-based counterclaim because the SEC had discretion "to
8 institute and maintain the present [enforcement] action."

9 The same conclusion was reached in S.E.C. v. Better Life Club of
10 America, Inc., 995 F. Supp. 167, 180 (D.D.C. 1998), *aff'd*, 203 F.3d 54
11 (D.C. Cir. 1999), *cert. denied sub nom. Taylor v. S.E.C.*, 528 U.S. 867
12 (1999). In that case, a defendant in an SEC enforcement action brought
13 counterclaims for tortious interference with contract and intentional
14 infliction of emotional distress on account of its enforcement actions.
15 The court dismissed these counterclaims under the discretionary
16 function exception because "[i]nvestigation and prosecution under § 21
17 of the Securities Acts is discretionary; therefore the United States is
18 immune to these claims." *Id.* at 180 (citing Board of Trade of City of
19 Chicago v. SEC, 883 F.2d 525, 531 (7th Cir. 1989)).

20 **3. The Unanimous Precedent is Supported by the**
21 **Justifications of the Discretionary Function Exception**

22 The Better Life Club court relied on an Administrative Procedures
23 Act case decided by the Seventh Circuit, Board of Trade v. SEC, 883
24 F.2d 525, 531 (7th Cir. 1989). In Board of Trade, the court refused to
25 exercise jurisdiction over two futures exchanges' claims that SEC had
26 abused its discretion by issuing a no-action order and refraining from
27 prosecuting a competing non-exchange "system" that acted as a clearing
28

1 agency for options trades. The court explained that the "[r]efusal to
2 prosecute is a classic illustration of a decision committed to agency
3 discretion," and under the Securities Exchange Act, "[i]nvestigation
4 and prosecution under § 21 are discretionary, not mandatory." 883 F.2d
5 at 530-31. Judge Easterbrook explained at length the reasons why these
6 decisions are discretionary and involve policy judgment:

7 Doing nothing may be the most constructive use of the
8 Commission's resources. Congress gives the SEC a budget, setting
9 a cap on its personnel. With limited numbers of staff-years, the
10 Commission must enforce several complex statutes. To do this
11 intelligently the Commissioners must assign priorities.
12 Prosecuting the System means less time for something else --
13 investigating claims of fraud in issuing new stock or conducting a
14 takeover contest, resolving disputes under the Investment Company
15 Act, and so on. Agencies may find it worthwhile to give short
16 shrift to a particular claim if the aggrieved party can file its
17 own suit (as the [plaintiff] futures markets may), for turning the
18 subject over to private litigation frees up time without
19 necessarily diminishing the enforcement of the statute. Yet even
20 when the aggrieved party cannot vindicate its own rights, as with
21 the National Labor Relations Act - indeed, even when the person
22 complaining about failure to prosecute is a defendant whose
23 business is going down the tubes - decisions about the best use of
24 the staff's time are for the prosecutor's judgment.

25 Courts cannot intelligently supervise the Commission's
26 allocation of its staff's time, because although judges see
27 clearly the claim the Commission has declined to redress, they do
28

1 not see at all the tasks the staff may accomplish with the time
2 released. Agencies must compare the value of pursuing one case
3 against the value of pursuing another; declining a particular case
4 hardly means that the SEC's lawyers and economists will go twiddle
5 their thumbs; case-versus-case is the daily tradeoff. Judges
6 compare the case at hand against a rule of law or an abstract
7 standard of diligence and do not see the opportunity costs of
8 reallocations within the agency. That fundamental difference in
9 the perspectives of the two bodies is why agencies (and other
10 prosecutors) rather than courts must make the decisions on
11 pursuing or dropping claims. Resource allocation is not a task
12 governed by "law". It is governed by budgets and opportunities.
13 Agencies "take Care that the Laws be faithfully executed" (Art.
14 II, § 3) by doing the best they can with the resources Congress
15 allows them. Judges could make allocative decisions only by
16 taking over the job of planning the agency's entire agenda,
17 something neither authorized by statute nor part of their
18 constitutional role.

19 Id. at 531 (internal citations omitted).

20 Thus, even if the plain language of the Securities Exchange Act
21 were insufficient to bar Plaintiffs' claims, Judge Easterbrook's policy
22 analysis explains the various reasons that the discretionary function
23 exception applies to the SEC's actions in the present case. Little
24 more needs to be said, except that numerous other court decisions
25 support this conclusion.

26 A large number of courts have held that SEC decisions are
27 unreviewable under the FTCA and/or the Administrative Procedures Act.
28

1 See, e.g., Block v. SEC, 50 F.3d 1078, 1084 (D.C. Cir. 1995) (rejecting
2 an Administrative Procedures Act action seeking to compel SEC action,
3 because “[s]o far, it appears, the Commission has found [its chosen
4 means] sufficient to induce compliance with the law. That the
5 petitioners prefer a different means of enforcement is irrelevant. . .
6 . [T]he agency alone, and neither a private party nor a court, is
7 charged with the allocation of enforcement resources.”); Sprecher v.
8 Von Stein, 772 F.2d 16, 18 (2d Cir. 1985) (claims arising out of
9 agency’s investigative operations are barred by FTCA immunity);
10 Sprecher v. Graber, 716 F.2d 968, 975 (2d Cir. 1983) (claims arising
11 out of agency’s investigative operations are barred by common law
12 immunity); Treats Intern. Ents., Inc. v. S.E.C., 828 F. Supp. 16, 18-19
13 (S.D.N.Y. 1993) (SEC’s investigative decisions are unreviewable under
14 Administrative Procedures Act); Standifer v. SEC, 542 F. Supp. 2d 1312,
15 1318 (N.D. Ga. 2008) (dismissing FTCA claims against SEC for numerous
16 reasons, including the fact that “[t]he SEC is granted broad discretion
17 by Congress to investigate possible violations of the securities laws
18 and to determine whether to bring civil or criminal actions to remedy
19 those violations.”); Leytman v. New York Stock Exchange, No. 95 CV 902,
20 1995 WL 761843, at *3 (E.D.N.Y. Dec. 6, 1995) (“Plaintiff [] seeks
21 damages from the Commission for its failure to investigate his claims
22 about the [New York Stock] Exchange’s alleged misconduct. . . . The
23 Securities Exchange Act of 1934 provides that stock exchange records
24 are subject to investigation by the [Securities and Exchange]
25 Commission ‘as the Commission . . . deems necessary or appropriate.’
26 15 U.S.C. 78q(b). The decision of whether or not to investigate a
27 stock exchange is left in the discretion of the Commission. [Under the
28

1 FTCA,] [e]ven if the Commission abuses that discretion, the court may
2 not intervene."); see also Thomas Lee Hazen, 6 The Law of Securities
3 Regulation, § 16.2, at 213 n.313 (6th ed. 2010 supp.) (collecting cases
4 involving SEC and non-governmental regulatory bodies).

5 In addition, courts have repeatedly held in other contexts that
6 the conduct of regulatory investigations are immune from FTCA liability
7 unless there are mandatory directives that limit the investigators'
8 discretion to determine both the **scope** and the **manner** of the
9 investigation. See, e.g., Alfrey v. United States, 276 F.3d 557, 565-
10 66 (9th Cir. 2002) (prison guards had discretion to determine how
11 thoroughly to search prisoners' cells); Sloan v. U.S. Dept. of Housing
12 and Urban Devel., 236 F.3d 756, 762 (D.C. Cir. 2001) ("[T]he sifting of
13 evidence, the weighing of its significance, and the myriad other
14 decisions made during investigations plainly involve elements of
15 judgment and choice."); Vickers v. United States, 228 F.3d 944, 951
16 (9th Cir. 2000) (stating that "the discretionary function exception
17 protects agency decisions concerning the scope and manner in which it
18 conducts an investigation so long as the agency does not violate a
19 mandatory directive."); Gen. Dynamics Corp. v. United States, 139 F.3d
20 1280, 1283-1284 (9th Cir. 1998) (government was immune under the
21 discretionary function exception where its auditors' allegedly
22 negligent investigations provided the factual basis for the
23 prosecutor's discretionary decision to prosecute); Sabow v. United
24 States, 93 F.3d 1445, 1452 (9th Cir. 1996) (government was immune under
25 the discretionary function exception for its investigators' allegedly
26 tortious investigation where "the guidelines promulgated by the
27 [agency] in its investigative manual were meant to be followed at the
28

1 discretion of [the agency's] investigating officers in light of the
2 specific circumstances surrounding a particular investigation.");
3 Fisher Bros. Sales, Inc. v. United States, 46 F.3d 279, 282 (3d Cir.
4 1995) (en banc) (government was immune under the discretionary function
5 exception where laboratory technicians' allegedly negligent
6 investigations done pursuant to mandatory guidelines provided the
7 factual basis for the Food and Drug Administration to seize allegedly
8 tainted fruit).

9 The weight and logic of this caselaw leads directly to the
10 conclusions proposed by the Government: the decisions of **whether** and
11 **how** to conduct investigations and enforcement actions are firmly lodged
12 in the SEC's discretion.

13 **4. Procedural Effect of SEC's Statutory and Regulatory**
14 **Discretionary**

15 As explained in Gaubert, "[w]hen established governmental policy,
16 as expressed or implied by statute, regulation, or agency guidelines,
17 allows a Government agent to exercise discretion, it must be presumed
18 that the agent's acts are grounded in policy when exercising that
19 discretion." 499 U.S. at 324. Because the Government has satisfied
20 this threshold burden the burden shifts to Plaintiffs to identify
21 particular acts and decisions that were either (1) mandatorily
22 prescribed by statute, regulation, or policy, or (2) were not
23 "susceptible to policy analysis." Id. at 323, 325.

24 **B. PLAINTIFFS' BROAD ALLEGATIONS OF MISCONDUCT ARE UNAVAILING**

25 At various points in their Complaint and moving papers, Plaintiffs
26 assert that the SEC violated various unidentified "[p]olicies and
27 practices," and "common-sense." (E.g., Compl. ¶ 12 (alleging that the
28

1 SEC staff "fail[ed] to follow the SEC's clear policies and
2 practices").¹³

3 To the extent that Plaintiffs rely on conclusory allegations about
4 "policies," "practices," and "common-sense," they have failed to rebut
5 Defendant's threshold showing. Broad allegations regarding undefined
6 "policies and practices" are insufficient under clear Ninth Circuit
7 precedent. In the recent decision in Doe v. Holy See, 557 F.3d at
8 1084-85, the Ninth Circuit examined the adequacy of a plaintiff's
9 pleadings under the discretionary function exception as articulated by
10 the Supreme Court in Gaubert.¹⁴ The court held that the complaint
11 failed to adequately allege the existence of non-discretionary duties
12 imposed on the government's officials because it only "refer[red]
13 vaguely . . . to the [defendant's] 'policies, practices, and
14 procedures.'" Id. at 1084 (quoting complaint). The court explained
15 that "nowhere does [plaintiff] allege the existence of a policy that is
16 'specific and mandatory' on the [defendant]. He does not state the
17 terms of this alleged policy, or describe any documents, promulgations,
18 or orders embodying it." Id. (quoting Kennewick Irrig. Dist. v. United
19 States, 880 F.2d 1018, 1026 (9th Cir. 1989)). In addition, the alleged
20 harmful acts were plainly susceptible to policy judgment, and under

22 ¹³ Plaintiffs explain that "'policies' refer[s] to formal or informal
23 policies, rules, standards, guidelines, procedures, codes, routines or other
24 directives implemented by the SEC to govern the conduct of its agents."
25 (Compl. ¶ 4 n.4.) "'Practices' refers to common-sense standards of conduct
26 required of SEC agents in the course of exercising their duties with
reasonable due care, regardless of whether the SEC had promulgated any
formal or informal policies with respect to that conduct." (Id.)

Under Gaubert, Plaintiffs' "practices" are clearly an inadequate basis
for showing a **mandatory** SEC duty.

27 ¹⁴ Technically, Doe v. Holy See involves the Foreign Sovereign Immunities Act
28 rather than the FTCA, but, as noted *supra*, the court solely examined FTCA
caselaw.

1 Circuit precedent, were “the type of discretionary judgments that the
2 [discretion function exception] was designed to protect.” Id. Because
3 of these glaring inadequacies, the court held that the discretionary
4 function exception applied.

5 Like the plaintiff in Doe v. Holy See, Plaintiffs in this case
6 largely fail to identify any mandatory “policies” or “practices” that
7 were violated in this case. (Cf. infra Part IV.C.) Plaintiffs’
8 “labels and conclusions” are insufficient to satisfy the pleading
9 requirements of Fed. R. Civ. P. 8(a)(2). See Iqbal, 129 S.Ct. at 1949
10 (quoting Twombly, 550 U.S. 544).

11 Likewise, Plaintiffs have wholly failed to identify any of the
12 SEC’s actions that were not “**susceptible** to policy analysis.” See
13 Gaubert, 499 U.S. at 325 (emphasis added). Their Complaint and their
14 moving papers do not contain any attempt to rebut the Government’s
15 preliminary showing that the SEC retained discretion to decide when to
16 investigate, how to investigate, and whether or not to take enforcement
17 actions. Plaintiffs attempt to recharacterize the nature of
18 Defendant’s burden, and argue that the Government bears the burden of
19 showing that the SEC’s actions were susceptible to policy analysis.
20 Plaintiffs are misguided. The Government has in fact satisfied its
21 burden: it has identified specific and discretionary statutes,
22 regulations, and caselaw-based policy arguments. See Doe v. Holy See,
23 557 F.3d at 1084-85 (where defendant identifies statutes, regulations,
24 and caselaw conferring policy-based discretion on actor, burden shifts
25 to plaintiff to identify allegations to rebut this showing).
26 Plaintiffs have failed to rebut Defendant’s showing.

27 ///
28

1 In light of the Government's showing that the SEC retains broad
2 discretion to regulate securities markets through formal and informal
3 means (see supra Part III.A), the Government has sufficiently satisfied
4 its threshold burden of showing that the relevant investigative and
5 enforcement decisions were discretionary and/or susceptible to policy
6 judgments. Under Gaubert, this threshold showing creates a "strong
7 presumption" that the discretionary function exception is satisfied.
8 Gaubert, 499 U.S. at 324. Plaintiffs' conclusory allegations regarding
9 "policies and practices" fail to rebut this presumption. See Doe v.
10 Holy See, 557 F.3d at 1084-85.

11 **C. PLAINTIFFS' ARGUMENTS ABOUT MANDATORY POLICIES ARE UNAVAILING**

12 In an oversized sur-reply,¹⁵ Plaintiffs attempt to satisfy their
13 burden of rebuttal by identifying five purportedly **mandatory** duties
14 imposed on the SEC and its staff. These are: sharing information;
15 obtaining trading records and other information from third parties;
16 hiring, training, and/or deploying qualified staff members; avoiding
17 improper personal motivations; and engaging in various administrative
18 case-management tasks.

19 As Plaintiffs themselves point out in their sur-reply, "it is
20 important to specifically identify the allegations of the Complaint
21 relating to the SEC's violation of mandatory policies." (Surreply at
22

23 ¹⁵ The Court never granted Plaintiffs leave to file a sur-reply. Nor did the
24 Court grant Plaintiffs leave to file an oversized brief. In addition, the
25 sur-reply goes far beyond the scope of the arguments raised in the
26 Government's Reply. Even if the Court had granted Plaintiffs leave to file
27 an oversized sur-reply, Plaintiffs would only have been allowed to address
28 Defendant's specific arguments in the Reply. Plaintiffs' sur-reply is
therefore procedurally improper.

It is therefore well within the Court's discretion to strike the sur-
reply. However, while the Court would ordinarily strike such an improper
filing, the Court will consider the merits of Plaintiffs' arguments in order
to foreclose certain of these claims in future proceedings.

1 5.) Yet Plaintiffs' factual allegations (which purport to incorporate
2 the Report in its entirety) fail to support these conclusions.
3 Plaintiffs almost wholly fail to allege that SEC's agents violated any
4 **mandatory** duties, and where Plaintiffs' allegations provide an
5 inference that such mandatory duties existed, Plaintiffs' arguments are
6 defeated by the holding in General Dynamics, 139 F.3d at 1284-85.
7 Plaintiffs therefore have failed to overcome the presumption that the
8 SEC's investigative and enforcement decisions were discretionary.
9 Accordingly, Plaintiffs' Complaint must be dismissed for lack of
10 subject matter jurisdiction.

11 **1. Duty to Share Information**

12 Plaintiffs' Complaint alleges that SEC teams failed to coordinate
13 their investigations among themselves and with the National Association
14 of Securities Dealers and Chicago Board of Options Exchange. (Surreply
15 at 6, citing Compl. ¶¶ 37, 62, 63, 78, 86, 103, 105, 123, 128, 130,
16 131.) According to Plaintiffs, these "negligent failures to
17 communicate . . . were prohibited by law." (Id.)

18 Plaintiffs have failed to support their assertions. Plaintiffs'
19 conclusory allegations fail to establish that SEC examiners were guided
20 by any mandatory duties requiring them to share information and
21 coordinate their activities.

22 Plaintiffs argue that Section 17 of the Securities Exchange Act of
23 1934, codified at 15 U.S.C. § 78q, imposes mandatory duties requiring
24 SEC staff to share information. The statute reads:
25
26
27
28

1 The Commission and the examining authorities¹⁶ **shall** share such
2 information [regarding securities exchanges and their members,
3 brokers and dealers, ratings organizations, and clearing
4 agencies], including reports of examinations, customer complaint
5 information, and other nonpublic regulatory information, **as**
6 **appropriate** to foster a coordinated approach to regulatory
7 oversight of brokers and dealers that are subject to examination
8 by more than one examining authority.

9 15 U.S.C. § 78q(k)(2) (emphasis added).

10 The statute clearly provides for SEC discretion. The mandatory
11 "shall" is modified by the discretionary "as appropriate." See Sabow,
12 93 F.3d at 1452 (distinguishing between "suggestive ('should') [and]
13 mandatory ('must') terms") (collecting cases). The statute itself
14 describes the nature of "appropriate" information-sharing: the
15 information-sharing must be "appropriate **to foster a coordinated**
16 **approach to regulatory oversight.**" 15 U.S.C. § 78q(k)(2) (emphasis
17 added). When the SEC is tasked with making decisions to "foster a
18 coordinated approach to regulatory oversight," these decisions are
19 inherently "grounded in social, economic, and political policy."
20 Gaubert, 499 U.S. at 323. Accordingly, the discretionary function
21 exception applies to information-sharing under § 78q(k)(2).

22 The legislative history supports this conclusion. This particular
23 subsection (formerly labeled subsection (i)) was added to the statute
24 in 1996 by the National Securities Markets Improvement Act of 1996,
25

26 ¹⁶ "For purposes of this subsection, the term 'examining authority' means a
27 self-regulatory organization registered with the Commission under this
28 chapter (other than a registered clearing agency) with the authority to
examine, inspect, and otherwise oversee the activities of a registered
broker or dealer." 15 U.S.C. § 78q(k)(5).

1 Pub.L. 104-290, § 108. It is instructive to contrast the statute's
2 final language with the language of the original House bill. The
3 House's bill included a complex set of reporting and coordination
4 requirements for self-regulatory organizations. See H.R. Rep. 104-622,
5 104th Cong., 2d Sess., 1996 U.S.C.C.A.N. 3877, 3877 (1996). The
6 original bill required, inter alia: annual meetings between the SEC and
7 self-regulatory organizations, § 108(a)(i)(2), periodic standardized
8 reporting requirements for the SEC and self-regulatory organizations, §
9 108(a)(i)(3), annual evaluations by an SEC-created panel,
10 § 108(a)(i)(7), and annual reports to Congress, § 108(a)(i)(8). Id.
11 These requirements were mandatory, not discretionary: the SEC and the
12 self-regulatory organizations had no flexibility in implementing these
13 clear congressional directives.

14 However, after some legislative wrangling, see H.R. Conf. Rep.
15 104-864, 1996 U.S.C.C.A.N. 3920, 3920 (1996), the House-Senate
16 conference committee stripped all of the above-mentioned requirements
17 and left intact only a few generalized requirements.¹⁷ The central
18 purpose of the final bill, as explained by the conference committee,
19 was to streamline regulation between federal and state authorities.
20 See id. at 3920-21. The purpose of the remaining portions of the bill
21 – apparently including § 108 – was “to eliminate duplication, promote
22 efficiency and protect investors.” Id. at 3921. This broad language
23 sets forth three general policy goals, the balancing of which requires
24

25
26 ¹⁷ As part of the compromise, the revised law required that the SEC
27 coordinate its activities with the self-regulatory organizations (whereas
28 the old bill merely required the self-regulatory organizations to coordinate
their activities). Compare 15 U.S.C. § 78q(k)(2) (“The Commission and the
examining authorities shall share . . .”) with H.R. 3005, § 108(a)(4)(A) in
H.R. Rep. 104-622 (“The examining authorities shall share . . .”).

1 the SEC to make inherently discretionary judgments. See also Milton R.
2 Schroeder, The Law of Regulation of Financial Institutions, ¶ 8.06[1]
3 (2009 update) ("The Act . . . calls for information sharing between
4 authorities and the elimination of unnecessary and burdensome
5 duplication in the examination process."); Rutherford B. Campbell, Jr.,
6 *Blue Sky Laws and the Recent Congressional Preemption Failure*, 22 J.
7 Corp. L. 175, 204 n.156 (1997) ("The Act . . . mandates that federal
8 authorities attempt to eliminate duplication and enhance coordination
9 and cooperation with the states as concerns the regulation of
10 brokers.").

11 In short, the law cited by Plaintiffs is purely discretionary.
12 Under the well-established requirements of the discretionary function
13 exception, this Court cannot second-guess the SEC's failure to
14 simultaneously accomplish all three of these competing policy goals set
15 out by Congress. The goals require policy judgment and resource
16 allocation, and are therefore subject to the discretionary function
17 exception.

18 **b. Plaintiffs' factual allegations**

19 In addition to these clear statutory rules, Plaintiffs' Complaint
20 expressly alleges that formal policies **did not** exist. The Report
21 (which is incorporated into the Complaint by reference) quotes one
22 staff member as stating that "there was no rule or policy about . . .
23 information-sharing at [the investigative] level between offices."
24 (Report at 133, 198, quoting testimony of Eric Swanson.) Taking this
25 allegation as true, Plaintiffs' Complaint directly contradicts the
26 conclusory assertions in their sur-reply.

27 ///
28

1 **c. Summary re: duty to share information**

2 Plaintiffs have therefore failed to meet their burden of
3 identifying either a mandatory duty requiring the SEC to share
4 information with other regulators, or plausible allegations that the
5 SEC's decisions regarding information-sharing were not susceptible to
6 policy analysis. The SEC retained discretion to determine the manner
7 and scope of its investigations. See Vickers, 228 F.3d at 951 ("[T]he
8 discretionary function exception protects agency decisions concerning
9 the scope and manner in which it conducts an investigation so long as
10 the agency does not violate a mandatory directive.").

11 **2. Failing to Request Materials from Third Parties**

12 Plaintiffs argue that the SEC violated "formal SEC policies" and
13 "basic auditing principles" by "repeatedly fail[ing] to request
14 materials from third parties to substantiate Madoff's claimed trading
15 activity." (Surreply at 8, citing Compl. ¶¶ 34-36, 67, 74, 77, 101,
16 143.) Again, Plaintiffs fail to identify any of the "formal SEC
17 policies" upon which they rely. But Plaintiffs insist that "SEC
18 staffers themselves considered it mandatory [to determine if Madoff was
19 actually making the trades he purported to be making], given one
20 staffer's characterization of the failure to do so as 'asinine.'" (Surreply at 10, quoting Compl. ¶ 77.)

21 Plaintiffs' arguments are not supported by their allegations. It
22 is unclear why an SEC staff member's use of the word "asinine" provides
23 evidence of an SEC policy. "Asinine" means "unintelligent, stupid,
24 silly, [or] obstinate." Webster's Third New International Dictionary
25 128 (1981). "Asinine" does not mean that a person has violated a non-
26
27
28

1 discretionary legal duty; nor does "asinine" mean that the person has
2 made a decision that is not susceptible to policy judgment.

3 Plaintiffs fail to identify any other allegations that state or
4 even imply the existence of mandatory duties to obtain records from
5 third parties. In fact, the Complaint is replete with factual
6 allegations suggesting that there were **no** SEC policies regarding
7 requesting information from third parties. The Report quotes a former
8 SEC staff member as stating that the SEC "**always**" obtained Depository
9 Trust Company statements "from the firm" being investigated rather than
10 from the Depository Trust Company itself. (Ex. A at 48, quoting
11 testimony of Demetrios Vasilakis, emphasis added.) The Report also
12 quotes a supervisor as stating that "most of the time we do not send
13 out [requests for trading] confirmations and do asset verification."
14 (Ex. A at 206, quoting testimony of Robert Sollazzo.) As a result of
15 these and other statements, the Report explained it was "common
16 practice" to rely on the firm under investigation, (Ex. A at 48), and
17 that "it was not unusual for [examiners] to rely **exclusively** on records
18 and data produced by the" firm being investigated. (Ex. A at 98,
19 emphasis added; see also Ex. A at 191 (noting that "it was not normal
20 practice in the exam program to reach out to entities" that centrally
21 cleared and settled trades).)

22 Because Plaintiffs' Complaint attempts to incorporate the Report
23 in its entirety, Plaintiffs therefore allege that there was **an absence**
24 of mandatory duties requiring SEC staff to use specific investigative
25 techniques. Although it may have been **good practice** for the SEC to
26 follow up with third parties, it was not **required** by mandatory SEC
27 policies. (See Compl. ¶ 35, citing Ex. A, at 290 n.202.)
28

1 Plaintiffs have therefore failed to plead facts that overcome the
2 discretionary function exception. The statutes, regulations, and
3 caselaw discussed *supra* establish beyond peradventure that the SEC
4 retained full discretion to determine the manner and scope of its
5 investigation. See Vickers, 228 F.3d at 951 (“[T]he discretionary
6 function exception protects agency decisions concerning the scope and
7 manner in which it conducts an investigation so long as the agency does
8 not violate a mandatory directive.”). Plaintiffs’ allegations fail to
9 rebut this presumption, by identifying either a formal mandatory duty
10 or a specific decision that was not susceptible to policy analysis.

11 **3. Assigning Unqualified Staff Members to Investigative**
12 **Teams**

13 Plaintiffs argue that “several SEC staffers were inexcusably
14 unqualified for their positions,” and that the SEC “assigned []
15 staffers who had no understanding of securities transactions, and were
16 otherwise unqualified, to the Madoff investigations.” (Surreply at 8,
17 citing Compl. ¶¶ 32, 37, 46, 61-64, 67, 88-89, 100, 118, 126, 132,
18 134.)

19 It is well-established that “employment, supervision and training”
20 decisions “fall squarely within the discretionary function exception.”
21 Nurse v. United States, 226 F.3d 996, 1001 (9th Cir. 2000); see also
22 Doe v. Holy See, 557 F.3d at 1084 (“the decision of whether and how to
23 retain and supervise an employee . . . [is] the type of discretionary
24 judgments that the exclusion was designed to protect. We have held the
25 hiring, supervision, and training of employees to be discretionary
26 acts.”); Gager v. United States, 149 F.3d 918 (9th Cir. 1998) (“The
27 [postal service’s] decision not to provide universal training and
28

1 supervision in mail bomb detection involved judgment or choice grounded
2 in social, economic, and political policy.”).

3 Plaintiffs have failed to identify any allegations that would
4 bring their case outside the purview of the Ninth Circuit’s general
5 caselaw on this question. Accordingly, Defendant has satisfied its
6 burden of showing that the relevant decisions fall within the
7 discretionary function exception, and Plaintiffs have not alleged any
8 facts to the contrary.

9 **4. Staff Members’ Personally Motivated Acts**

10 Plaintiffs argue that SEC “staffers [] acted out of personal
11 animus, unfounded fear of individual liability, and improper deference
12 to Madoff on account of his reputation,” and that “one staffer ignored
13 a whistleblower out of spite.” (Surreply at 8, citing Compl. ¶¶ 23,
14 97-99, 119, 121-22.)

15 All of these assertions strike at the **manner** in which the SEC
16 conducted its investigations. As noted repeatedly in this Order, the
17 SEC retained discretion to make policy-based decisions about the **manner**
18 and **scope** of its investigations. See 15 U.S.C. § 78u(a)(1) (permitting
19 SEC to decide “as it deems necessary” how to “investigate any facts,
20 conditions, practices, or matters,” whether through “a statement in
21 writing, under oath or otherwise.”); see also Vickers, 228 F.3d at 951
22 (“[T]he discretionary function exception protects agency decisions
23 concerning the scope and manner in which it conducts an investigation
24 so long as the agency does not violate a mandatory directive.”).

25 Plaintiffs’ allegations, taken as true, at most establish that the
26 SEC staff abused its discretion when conducting investigations into
27 Madoff’s operations. However, the FTCA clearly states that the
28

1 discretionary function applies “whether or not the discretion involved
2 be abused.” 28 U.S.C. § 2680(a). In addition, Supreme Court precedent
3 requires this Court to examine “the nature of the actions taken and []
4 whether they are susceptible to policy analysis,” not “the agent’s
5 **subjective intent** in exercising the discretion conferred by statute or
6 regulation.” Gaubert, 499 U.S. at 324 (emphasis added). Accordingly,
7 the SEC staff’s subjective reasons for deciding how to investigate
8 Madoff are irrelevant to the present inquiry.¹⁸

9 Furthermore, the relevant question is not, as Plaintiffs suggest,
10 whether the agents’ activities were **actually** “grounded in any
11 legitimate policy considerations.” (Surreply at 9.) Rather, the
12 question is whether the agents’ activities were **susceptible** to policy
13 analysis. See Gaubert, 499 U.S. at 324; Terbush, 516 F.3d at 1129.
14 Investigative decisions are inherently susceptible to policy analysis,
15 and Plaintiffs fail to identify any mandatory laws, regulations, or
16 policies that prescribe a specific course of action for the staff to
17 follow when conducting investigations. Accordingly, these decisions
18 are subject to the discretionary function exception.

19 **5. Failing to Follow Case-Management Procedures**

20 Plaintiffs next argue that the SEC “violated its own internal
21 policies” regarding case-management by doing the following: (1)
22 “failing to obey rules regarding the filing of reports and the use of
23 the SEC’s STARS [Super Tracking and Reporting System] computer system,”
24 (2) failing to consult the Super Tracking and Reporting System database
25

26 ¹⁸To the extent that SEC staff members were truly acting for personal
27 purposes, such activities would not constitute a “negligent or wrongful act
28 or omission of any employee of the Government while acting **within the scope**
of his office or employment,” and the FTCA would not provide an avenue for
recovery. 28 U.S.C. § 1346(b)(1) (emphasis added).

1 before beginning examinations, (3) "fail[ing] to submit Matter Under
2 Inquiry [] reports with respect to . . . open investigations," and (4)
3 failing to file case-opening and case-closing reports. (Surreply at
4 7.)

5 Plaintiffs have adequately alleged that the SEC teams failed to
6 conduct each of these tasks at one time or another. Plaintiffs have
7 not, however, adequately alleged that these tasks were **mandatory** or
8 were not otherwise susceptible to **policy judgment**. Because the SEC
9 staff had broad discretion to determine how to conduct its
10 investigations, see supra Part IV.B, Plaintiffs bear the burden of
11 identifying plausible allegations that non-discretionary duties were
12 imposed on the investigators. See, e.g., Sabow, 93 F.3d at 1452-53
13 (closely examining Naval Investigative Service/Judge Advocate General
14 investigation manuals to determine whether investigators were obligated
15 to conduct investigations in particular manner); Alfrey v. United
16 States, 276 F.3d 557, 563 (9th Cir. 2002) (holding that prison guard's
17 failure to search a computer database was part of discretionary
18 investigatory decision where there was no policy requiring such a
19 search to be conducted); cf. Franklin Sav. Corp. v. United States, 180
20 F.3d 1124, 1132-33 (10th Cir. 1999) (agency not immune where its
21 employees failed to prepare mandatory case memoranda; however,
22 plaintiff's claims were dismissed on the merits because no injury
23 flowed from the failure to prepare the memoranda). Plaintiffs have not
24 met their burden.

25 **a. Factual Allegations**

26 In May 2003, the Washington-based Office of Compliance Inspections
27 and Examinations received a tip and referred the matter to a team in
28

1 the Broker-Dealer section. In December 2003, the Washington team
2 received a second tip and opened its investigation into Madoff.
3 According to Plaintiffs, the team failed to file case-opening report in
4 the STARS computer system. (Compl. ¶ 80.) There is one allegation
5 suggesting that case-opening report is mandatory: the Report quotes a
6 supervisor's statement that the staff members were "supposed to" enter
7 their case-opening "information into the tracking system." (Ex. A at
8 132, quoting McCarthy testimony.) The Washington team also failed to
9 follow its case-planning memo. (Compl. ¶ 69.) There are no factual
10 allegations, however, that there is a mandatory duty to follow a case-
11 planning memorandum.

12 In April 2004, the Washington team closed its investigation and
13 failed to file a case-closing memorandum. (Compl. ¶¶ 78, 80.) There
14 is one allegation that the case-closing memo may have been mandatory:
15 the Report quotes a supervisor's statement that "[t]ypically, staff is
16 supposed to – when they finish an exam[ination] they're supposed to
17 close it out and I think there should have been a close-out memo is my
18 understanding." (Compl. ¶ 78 & n.15, quoting Ex. A at 136 (quoting
19 McCarthy testimony).)

20 At the same time that the Washington team closed its investigation
21 (April 2004), the first New York enforcement team received a tip, and
22 in December 2004 the New York team opened its investigation. (Compl. ¶
23 86.) This team failed to draft a planning memorandum. (Compl. ¶¶ 87,
24 108.) Plaintiffs state in a conclusory fashion that there was an SEC
25 "policy or practice" requiring such a memorandum, but support this
26 assertion by citing to a factual statement in the Report that quotes
27
28

1 staff members saying that there was **not** such a policy at the time of
2 the investigation. (Compl. ¶ 87, citing Ex. A at 166.)

3 The New York team failed to consult the STARS computer system to
4 see if any prior case-opening reports had been filed. (Compl. ¶¶ 103,
5 108.) There is no specific allegation that there is a mandatory duty
6 to check the computer system; however, Plaintiffs allege that SEC
7 policy required that "there should never be two examinations of the
8 same entity being conducted at the same time without both teams being
9 aware of each other's examination." (Compl. ¶ 103, quoting Ex. A at
10 132.) In the Ninth Circuit, the word "should" is generally viewed as
11 **suggestive** rather than **mandatory**, see, e.g., Sabow, 93 F.3d at 1452,
12 and a person's **subjective belief** that something "should" be done is
13 inadequate evidence that there is "in fact [a] mandatory [duty] under
14 some federal regulation or [internal] policy." Alfrey, 276 F.3d at
15 563. However, viewing this quotation in the light most favorable to
16 Plaintiffs, there may be a plausible inference that there was a
17 mandatory policy to check the STARS computer system or that the
18 decision to check the STARS computer was not susceptible to policy
19 analysis. (See surreply at 12, 25.) Plaintiffs therefore allege that
20 the Washington and first New York teams violated internal policies
21 and/or made decisions that were not susceptible to policy judgment.
22 These acts and omissions will be examined in greater detail *infra*.

23 Plaintiffs further allege that the first New York team learned
24 about the previous Washington examination while the New York team was
25 interviewing Madoff in mid-to-late May 2005. (Ex. A at 195.) In early
26 June 2005, the Washington team sent its files to the New York team, and
27 the New York team performed a "cursory review" of the Washington team's
28

1 findings because the information "seemed so similar to what we [the New
2 York team] were receiving in real time." (Compl. ¶ 105, quoting Ex. A
3 at 200.) Plaintiffs allege that the two teams' failures to fully
4 communicate "resulted in embarrassment and a waste of Commission
5 resources as two examination teams from two different offices
6 essentially conducted the same examination." (Ex. A at 142; see also
7 Compl. ¶ 1 n.3 (incorporating Report in its entirety into Complaint).)

8 In September 2005, the first New York team formally closed its
9 investigation. In October 2005, after Harry Markopolos's third report
10 was referred from the Boston office, a different New York team began a
11 new investigation into Madoff's operations. In December 2005, this
12 second New York team filed its "Matter Under Inquiry" report. (Compl.
13 ¶ 124.) The New York office received another tip about Madoff between
14 the October 2005 opening of the investigation and the December 2005
15 filing of the Matter Under Inquiry report. (Compl. ¶ 125.) Plaintiffs
16 allege that, had the Matter Under Inquiry been filed in October, this
17 new tip would have been part of the second New York team's
18 investigation. (Compl. ¶ 125.) However, there are no factual
19 allegations that SEC policy requires that a Matter Under Inquiry form
20 be filed immediately, other than Plaintiffs' conclusory allegations
21 that this a "required step at the beginning of any Enforcement
22 investigation." (Compl. ¶ 124.) Contradicting this conclusory
23 assertion, Plaintiffs' Complaint contains specific factual assertions
24 that, although the Matter Under Inquiry "should" have been opened
25 sooner, the SEC's enforcement manual states that staff members "**may**"
26 file a Matter Under Inquiry if and when they determine that a complaint
27 is "serious and substantial." (Compl. ¶ 125, citing Ex. A at 263
28

1 (quoting SEC Enforcement Manual) (emphasis added).) Plaintiffs further
2 allege that "it is unclear whether the tip would have made any
3 difference in the conduct or the result of the [second New York team's]
4 investigation because . . . of [the investigating attorney's] view that
5 anonymous tips, 'on their face' were not credible." (Ex. A at 265; see
6 also Compl. ¶ 1 n.3 (incorporating Report in its entirety into
7 Complaint).)

8 In June 2006, after completing its examination, the second New
9 York team filed its case-closing report despite the fact that it had
10 failed to resolve all of the red flags it identified. (Compl. ¶ 147.)
11 However, there are no allegations that the SEC staff is required to
12 resolve red flags before deciding to close a case and file a case-
13 closing report. (See Compl. ¶ 147.)

14 **b. Discussion and Analysis**

15 In short, viewing the plausible inferences of the Complaint's
16 factual averments in favor of Plaintiffs, the Complaint alleges three
17 acts that violated mandatory duties and/or were not susceptible to
18 policy judgment:

- 19 (1) the Washington team failed to file a case-opening report;
20 (2) the first New York team failed to consult the STARS computer
21 database to find prior case-opening reports regarding Madoff; and
22 (3) the Washington team failed to file a case-closing memorandum.

23 Plaintiffs' other assertions are either unsupported by any factual
24 allegations whatsoever¹⁹ or are supported by factual allegations that
25

26
27 ¹⁹ There are no specific allegations stating that there was a requirement to
28 follow a case-planning memorandum. Nor are there specific allegations
stating that there was a requirement to resolve red flags prior to closing a
case and preparing a case-closing memorandum.

1 plainly contradict Plaintiffs' conclusory assertions that there was a
2 mandatory duty and/or decision not susceptible to policy analysis.²⁰
3 Plaintiffs further allege that the three specific SEC omissions had an
4 extremely limited impact. Plaintiffs assert that the New York team,
5 prior to closing its investigation, received and reviewed the
6 Washington files – albeit in a "cursory" manner because the information
7 appeared duplicative of the New York team's ongoing investigations.
8 (Compl. ¶ 105, citing Ex. A at 200.)

9 Ultimately, then, Plaintiffs are alleging that two SEC offices
10 violated mandatory policies and thereby failed to adequately coordinate
11 their investigations and otherwise conduct their investigations in a
12 thorough and adequate manner.

13 As has been shown repeatedly throughout this Order, the SEC
14 retained discretion to decide how to conduct its investigations – which
15 includes decisions about how to coordinate investigations between
16 offices. (See supra Parts. IV.B.1, IV.B.3.) At the risk of being
17 repetitive, it is useful to refer back to 15 U.S.C. § 78u(a)(1), which
18 permits the SEC to decide "as it deems necessary" how to "investigate
19 any facts, conditions, practices, or matters," whether through "a
20 statement in writing, under oath or otherwise." In addition, 15 U.S.C.
21 § 78u(d)(1) permits the SEC "in its discretion" to bring an enforcement
22 action when it detects a securities violation during its
23 investigations. There are, in short, no mandatory obligations
24

25
26 ²⁰ Plaintiffs' conclusory assertions that there were mandatory duties are
27 contradicted by their specific allegations in the Report that there was no
28 policy requiring staff to prepare a case-planning memorandum and there was a
discretionary policy (which used the suggestive "should" and the permissive
"may," see Sabow, 93 F.3d at 1452) regarding staff members' decisions to
file a Matter Under Inquiry report.

1 requiring the SEC to conduct its investigations in a particular manner
2 or to bring an enforcement action in particular situations. These
3 decisions are fundamentally discretionary and require staff to make
4 policy-based judgments. See, e.g., Sloan, 236 F.3d at 762 (“[T]he
5 sifting of evidence, the weighing of its significance, and the myriad
6 other decisions made during investigations plainly involve elements of
7 judgment and choice.”); Vickers, 228 F.3d at 951 (“[T]he discretionary
8 function exception protects agency decisions concerning the scope and
9 manner in which it conducts an investigation.”).

10 In light of this broad investigatory discretion, General
11 Dynamics is therefore directly on point regarding the small handful of
12 mandatory procedural obligations imposed on SEC staff. In General
13 Dynamics, the Ninth Circuit explained that an otherwise actionable
14 agency decision is immune from suit if “a totally separate exercise” of
15 “independent” and “broad based discretion” “intervenes between an
16 alleged government wrongdoer and the harm suffered by a plaintiff.”
17 139 F.3d at 1285. There, prosecutors brought a criminal action against
18 General Dynamics based solely on facts stated in a negligently prepared
19 auditing statement. The court explained that the prosecutors’
20 affirmative decision to prosecute constituted an independent exercise
21 of broad-based discretion that thereby insulated the government from a
22 lawsuit based on the auditors’ non-discretionary actions. Id. The
23 court noted that the “source of the [plaintiff’s] injury” was the
24 independent and “discretionary” decision to prosecute. Id. Although
25 the prosecutors could have sought more information and could have
26 double-checked the auditors’ reports, they retained discretion to
27 ///
28

1 choose whether or not to do so, and they affirmatively decided to rely
2 only on the inaccurate reports. Id.

3 In contrast, in Glacier Bay, hydrographers prepared oceanographic
4 charts pursuant to mandatory requirements stated in their handbook.
5 They then presented these charts to their supervisor, who had
6 discretion regarding whether or not to approve those charts. The court
7 held that the supervisor's limited exercise of discretion did not
8 immunize the hydrographers' negligent preparation of the charts in
9 violation of mandatory guidelines. As the court later explained in
10 General Dynamics, "little intervened between the hydrographers'
11 wrongdoing and the injury to the plaintiff." General Dynamics, 139
12 F.3d at 1285. Instead, there was a "tight coupling between
13 hydrographers, reviewers, charts, and results," such that the plaintiff
14 was injured by the hydrographers' violation of the mandatory guidelines
15 in preparing the charts, and was not injured by the supervisor's
16 discretionary approval of the charts. Id. at 1284.

17 The allegations in the present case are far more analogous to the
18 facts in General Dynamics than in Glacier Bay. Plaintiffs allege in
19 essence that the first New York investigative team had a mandatory duty
20 to be aware of the prior Washington investigation. Plaintiffs'
21 allegations are neatly summarized in a quotation in the Complaint:
22 under SEC policy "there should **never** be two examinations of the same
23 entity being conducted at the same time without both teams being aware
24 of each other's examination." (Compl. ¶ 102, quoting Ex. A at 132,
25 emphasis added by Court.)²¹

26
27 ²¹ Again, the Court notes that the word "should" is suggestive rather than
28 mandatory and officials' subjective beliefs are insufficient evidence of a
mandatory policy. However, at the present stage of proceedings, plausible

1 However, even though these two teams' conduct violated mandatory
2 policies or otherwise involved non-judgment-based decisions, the
3 discretionary function exception will apply if "a totally separate
4 exercise" of "independent" and "broad based discretion" "intervenes
5 between an alleged government wrongdoer and the harm suffered by a
6 plaintiff." General Dynamics, 139 F.3d at 1285. Here, Plaintiffs were
7 harmed by the investigators' failure to discover the Madoff fraud and
8 publicize or prosecute it. Plaintiffs were not harmed by the teams'
9 failure to follow case-management procedures because the first team of
10 New York investigators undertook an independent exercise of discretion
11 when they (1) received and reviewed the Washington team's files and
12 determined that the Washington team's investigative materials were
13 duplicative of their own investigation (Compl. ¶ 105, quoting Ex. A at
14 200), (2) conducted their own independent investigation into Madoff's
15 operations (Compl. ¶¶ 82-109), and (3) determined that there was no
16 basis for bringing an enforcement action against Madoff (Compl. ¶ 107).

17 Each of these three acts by the New York team was a "totally
18 separate exercise of discretion" that was unrelated to the
19 investigators' non-discretionary violations of mandatory case-
20 management rules. See General Dynamics, 139 F.3d at 1285. The New
21 York investigators retained "broad based discretion," id. at 1285, to
22 select the manner and scope of their investigation of Madoff and their
23 review of the Washington team's files. This "broad based discretion"
24 is derived both from the SEC's congressionally-authorized discretion to

25
26
27 _____ infernces in the Complaint must be drawn in Plaintiffs' favor. This
28 quotation, combined with the other factual allegations discussed supra, provide a plausible inference that these particular case-management obligations were mandatory.

1 choose the manner and scope of its investigations, see 17 U.S.C. §§
2 78u(a)(1), 78u(d)(1), and from the inherently discretionary nature of
3 investigative activities. See, e.g., Sloan, 236 F.3d at 762 (“[T]he
4 sifting of evidence, the weighing of its significance, and the myriad
5 other decisions made during investigations plainly involve elements of
6 judgment and choice.”); Vickers, 228 F.3d at 951 (“[T]he discretionary
7 function exception protects agency decisions concerning the scope and
8 manner in which it conducts an investigation.”).

9 In addition, the New York team, after conducting an independent
10 and discretionary review of both Madoff’s operations and the Washington
11 team’s files, made an independent decision to close its investigation
12 in September 2005 without bringing an enforcement action against
13 Madoff. The decision of whether or not to bring an enforcement action
14 is plainly discretionary. See 17 U.S.C. § 78u(d)(1) (permitting SEC
15 “in its discretion” to bring enforcement actions); 17 C.F.R. § 202.5
16 (stating that SEC “may in its discretion” select from various
17 enforcement tools if it believes that enforcement action is necessary).
18 Although FTCA claims most often involved negligent agency **actions**
19 rather than **failures** to act, the New York team’s decision **not to act**
20 was fully within its discretion in selecting the manner and scope of
21 its investigations and enforcement actions. See, e.g., Block v. SEC,
22 50 F.3d at 1084 (in Administrative Procedures Act action, SEC cannot be
23 compelled to undertake certain enforcement actions); Board of Trade v.
24 SEC, 883 F.2d at 531 (same); Leytman v. New York Stock Exchange, 1995
25 WL 761843, at *3 (dismissing FTCA claims alleging that SEC failed to
26 investigate alleged wrongdoing).

27 ///
28

1 In short, General Dynamics applies to the allegedly negligent acts
2 by the Washington team and the first New York team. The New York
3 team's intervening discretionary actions are closely analogous to the
4 General Dynamics prosecutors' actions in at least two ways:

5 (1) In General Dynamics, the prosecutors reviewed and relied on
6 information contained in a negligently-conducted investigation when
7 choosing to pursue a prosecution. Here, the first New York team
8 reviewed the Washington team's allegedly negligently-prepared files and
9 the New York team relied (at least part) on those files in choosing to
10 close the case without pursuing an enforcement action. In both cases,
11 the second actor retained discretion to decide how thoroughly to rely
12 on (or discredit) the underlying information received from a previous
13 investigation. In both cases, the second actor exercised that
14 discretion: in General Dynamics, the prosecutors elected not to conduct
15 a further investigation, and here, the New York team elected to conduct
16 a " cursory " review of the Washington team's files.

17 (2) In General Dynamics, the prosecutors retained discretion to
18 conduct additional independent investigations before deciding whether
19 or not to file a criminal action; they elected to file the action
20 without seeking additional information beyond that contained in the
21 auditing reports. Here, the first New York team retained discretion to
22 conduct further investigations into Madoff's affairs before deciding
23 whether or not to bring enforcement actions against Madoff. Unlike the
24 prosecutors in General Dynamics, the New York team elected to conduct
25 additional independent investigations beyond those contained in the
26 Washington team's files, and the New York team further elected to close

27 ///
28

1 its case without bringing an enforcement action.²² The New York team in
2 fact exercised greater discretion than the prosecutors in General
3 Dynamics - the prosecutors in General Dynamics were presented with
4 clear (albeit incorrect) evidence showing fraud; it does not exactly
5 require "a robust exercise of discretion" to decide to prosecute that
6 fraud. 139 F.3d at 1285. Here, however, neither the Washington team
7 nor the New York team uncovered any actionable wrongdoing.
8 Accordingly, the New York team exercised relatively "robust" discretion
9 by deciding to investigate the allegations further and ultimately
10 concluding on the basis of that investigation not to bring an
11 enforcement action.

12 Thus, the New York team's actions - its affirmative choice to
13 review the Washington team's files; its affirmative choice to conduct
14 additional investigations into Madoff's operations; and its affirmative
15 choice not to bring an enforcement action - constituted intervening
16 exercises of independent and broad-based discretion. Both the facts
17 and holding of General Dynamics are directly on-point. As such, the
18 discretionary function exception bars Plaintiffs' claims regarding the
19 Washington and New York investigators' alleged failures to follow
20 mandatory case-management procedures.

21 ///
22

23
24 ²² Even though Plaintiffs allege that the New York team's review of the
25 Washington team's files was "cursory," the General Dynamics court clearly
26 explained that it is inappropriate to consider the thoroughness or accuracy
27 of an intervening exercise of "broad based discretion." See 139 F.3d at
28 1285. The General Dynamics prosecutors "**could have** had even more
information if they had chosen to pursue it." Id. (emphasis added).
Likewise, the first New York team **could have** conducted additional
investigations into Madoff's operations or reviewed the Washington team's
files more thoroughly. However, the first New York team retained "broad
based discretion" to choose the methods and scope of its investigation.

1 **6. Conclusion Regarding Plaintiffs' Purportedly Mandatory**
2 **Duties**

3 Plaintiffs have failed to identify any of the SEC's non-
4 discretionary acts that are actionable under Ninth Circuit precedent.
5 As such, they have not rebutted the "strong presumption" established in
6 the statutes, regulations, and caselaw in Defendant's favor. Gaubert,
7 499 U.S. at 324. The discretionary function exception bars Plaintiffs'
8 claims.

9
10 **V. PLAINTIFFS' REQUEST TO CONDUCT DISCOVERY**

11
12 Plaintiffs insist that as-yet-undiscovered internal policies and
13 guidelines will reveal that the SEC's actions violated clear mandatory
14 rules. (Surreply at 9, 11.) However, Plaintiffs have not plausibly
15 alleged any facts suggesting that such mandatory rules exist. In
16 addition, Plaintiffs have failed to identify the specific types of
17 rules that are likely to exist. Finally, Plaintiffs have failed to
18 consult the voluminous public record that might bolster their
19 conclusory assertions or potentially contradict them. In short,
20 Plaintiffs have failed to allege sufficient "facts to raise a
21 reasonable expectation that discovery will reveal evidence" supporting
22 their conclusory assertions. Twombly, 550 U.S. at 556. This Court is
23 barred from "unlock[ing] the doors of discovery for a plaintiff armed
24 with nothing more than conclusions." Ashcroft v. Iqbal, 129 S. Ct. at
25 1950. Accordingly, discovery is inappropriate at this juncture.

26 ///

27 ///

1 **A. LEGAL STANDARD**

2 "[W]here pertinent facts bearing on the question of jurisdiction
3 are in dispute, discovery should be allowed." Am. West Airlines, Inc.
4 v. GPA Group, Ltd., 877 F.2d 793, 801 (9th Cir. 1989). However, a
5 "court's refusal to allow further discovery before dismissing on
6 jurisdictional grounds is not an abuse of discretion 'when it is clear
7 that further discovery would not demonstrate facts sufficient to
8 constitute a basis for jurisdiction.'" Id. at 801 (quoting Wells Fargo
9 & Co. v. Wells Fargo Express Co., 556 F.2d 406, 430-31, n. 24 (9th Cir.
10 1977)).

11 In the FTCA immunity context, "[i]t is well-established that 'the
12 burden is on the party seeking to conduct additional discovery to put
13 forth sufficient facts to show that the evidence sought exists.'" Gager v. United States, 149 F.3d 918, 922 (9th Cir. 1998) (quoting
14 Conkle v. Jeong, 73 F.3d 909, 914 (9th Cir. 1995)) (internal
15 alterations omitted). In this regard, it is important to remember that
16 the Rule 8 pleading requirements prevent parties from filing complaints
17 in order to conduct aimless fishing expeditions in the hope that some
18 helpful evidence might possibly be uncovered. See Ashcroft v. Iqbal,
19 129 S. Ct. at 1950 ("Rule 8 . . . does not unlock the doors of
20 discovery for a plaintiff armed with nothing more than conclusions.");
21 Twombly, 550 U.S. at 556 ("[A]sking for plausible grounds to infer"
22 that a wrongful act occurred requires plaintiff to plead "enough facts
23 to raise a **reasonable expectation** that discovery will reveal evidence
24 of" that wrongful act) (emphasis added).

25
26 The Ninth Circuit applied Twombly to the discretionary function
27 exception in Doe v. Holy See, 557 F.3d at 1084-86. The court affirmed
28

1 a dismissal under the Foreign Sovereign Immunities Act's discretionary
2 function exception where the defendant made only a "facial attack on
3 the allegations of subject-matter jurisdiction in the complaint." Id.
4 at 1086. The court dismissed the complaint because it contained only
5 conclusory assertions that the defendant had adopted a mandatory policy
6 relevant to the cause of action, and the plaintiff wholly failed to
7 "state the terms of this alleged policy, or describe any documents,
8 promulgations, or orders embodying it." Id. Notably, the court did
9 not require that the plaintiff have an opportunity to conduct discovery
10 into the existence of this alleged policy. See id. at 1084-86.
11 Instead, the court merely analyzed the adequacy of the plaintiff's
12 pleadings, and, finding them to be insufficient under Twombly, affirmed
13 dismissal under the discretionary function exception. Id. at 1086.

14 Even prior to the Supreme Court's re-articulation of the proper
15 pleading requirements in Twombly and Iqbal, it was not unusual for
16 courts to dismiss FTCA claims under the discretionary function
17 exception without giving litigants an opportunity to conduct discovery.
18 See, e.g., Abreu v. United States, 468 F.3d 20, 33 (1st Cir. 2006);
19 Dalli v. Frech, 70 Fed. Appx. 46 (2d Cir. 2003); see also Mesa v.
20 United States, 123 F.3d 1435, 1439 (11th Cir. 1997) (affirming
21 dismissal under discretion function exception where "[plaintiffs] have
22 pointed to no act of these DEA agents that could fall outside of the
23 discretionary function exception, nor have the [plaintiffs] pointed to
24 any requested discovery that could reasonably be expected to reveal any
25 such act."); accord Razore v. Tulalip Tribe of Wash., 66 F.3d 236, 240
26 (9th Cir. 1995) (affirming dismissal of CERCLA action on jurisdictional
27 grounds without permitting parties to conduct discovery); but see

28

1 Ignatiev v. United States, 238 F.3d 464, 467 (D.C. Cir. 2001) (holding
2 that D.C. Circuit "require[s] that plaintiffs be given an opportunity
3 for discovery of facts . . . [regarding the] existence [or not] of
4 internal governmental policies guiding that action.").²³

5 **B. DISCUSSION AND ANALYSIS**

6 Additional discovery is not appropriate at present. Plaintiffs
7 have not pleaded "enough facts to raise a reasonable expectation that
8 discovery will reveal evidence of" the sought-after SEC policies and
9 guidelines. Twombly, 550 U.S. at 556. In their request for discovery
10 contained in the sur-reply, Plaintiffs have failed to meet their
11 burden of "put[ting] forth sufficient facts to show that the evidence
12 sought exists." Gager, 149 F.3d at 922.

13 A salient analogy can be found in Freeman v. United States, 556
14 F.3d 326 (5th Cir.), *cert. denied*, 130 S.Ct. 154 (2009). In that case,
15 the court held that the "plaintiffs have failed to articulate a
16 discrete discovery request that might cure the jurisdictional
17

18 ²³ The D.C. Circuit's Ignatiev opinion requires that district courts in that
19 Circuit allow FTCA plaintiffs an opportunity to pursue limited discovery to
20 determine whether or not internal agency guidelines mandate staff members to
21 take a particular course of action. It is unclear whether Ignatiev's
22 bright-line rule survives post-Twombly and -Iqbal, both of which state that
23 something more than a conclusory allegation is required to obtain discovery.
24 As the Supreme Court explained in Iqbal:

25 Respondent . . . implies that our construction of Rule 8 should be
26 tempered where, as here, the Court of Appeals has "instructed the
27 district court to cabin discovery in such a way as to preserve"
28 petitioners' defense of qualified immunity "as much as possible in
anticipation of a summary judgment motion." Iqbal Brief 27. We have
held, however, that the question presented by a motion to dismiss a
complaint for insufficient pleadings does not turn on the controls
placed upon the discovery process. Twombly, [550 U.S.] at 559 ("It is
no answer to say that a claim just shy of a plausible entitlement to
relief can, if groundless, be weeded out early in the discovery
process through careful case management given the common lament that
the success of judicial supervision in checking discovery abuse has
been on the modest side.").

Iqbal, 129 S.Ct. at 1953.

1 deficiency and have failed to otherwise specify where they might
2 discover the necessary factual predicate for subject matter
3 jurisdiction." Id. at 342. The Freeman case is particularly relevant
4 because it involved a "well-documented" government failure akin to the
5 one at issue in the present case: the government's response to
6 Hurricane Katrina. Id. at 343. The court stated that it found "no
7 fault in the district court's conclusion that a mandatory directive, if
8 one existed, could be found in the public realm" because "in this case
9 plaintiffs' allegations are based on statutes, regulations, and other
10 authorities that are publicly available." Id. 342.

11 Freeman is particularly apt because the plaintiffs in that case
12 relied heavily "on numerous congressional investigations regarding the
13 government's response to Hurricane Katrina." Id. at 342 n.16. In the
14 case before this Court, Plaintiffs rely almost exclusively on the SEC
15 Office of Inspector General's Report. Plaintiffs have done nothing
16 more than read a small portion of the voluminous public record
17 regarding the relevant factual issues.

18 Notably, Plaintiffs have not shown that the relevant information
19 is unavailable to them in the absence of discovery. To the contrary,
20 the SEC Inspector General has issued a follow-up report that
21 specifically examines the Office of Compliance Inspections and
22 Examinations's "modules, policies, procedures and guidance associated
23 with the conduct of its examinations" into Madoff's conduct. The Court
24 further notes that countless other relevant documents are readily
25 available through the SEC's website.

26 Accordingly, Plaintiffs' request for discovery is denied.

27 ///

28

1 **VI. LEAVE TO AMEND THE COMPLAINT**

2
3 When a court grants a motion to dismiss, the court may grant the
4 plaintiff leave to amend a deficient claim "when justice so requires."
5 Fed. R. Civ. P. 15(a)(2). The plaintiff need not specifically request
6 leave to amend. Doe v. United States, 58 F.3d 494, 497 (9th Cir.
7 1995); but see Reyn's Pasta Bella, LLC v. Visa USA, Inc., 442 F.3d 741,
8 749 (9th Cir. 2006) ("Although Plaintiffs' complaint is susceptible of
9 amendment, we generally will not remand with instructions to grant
10 leave to amend unless the plaintiff sought leave to amend below.")
11 (citing Alaska v. United States, 201 F.3d 1154, 1163-64 (9th Cir.
12 2000)). "Five factors are frequently used to assess the propriety of a
13 motion for leave to amend: (1) bad faith, (2) undue delay, (3)
14 prejudice to the opposing party, (4) futility of amendment; and (5)
15 whether plaintiff has previously amended his complaint." Allen v. City
16 of Beverly Hills, 911 F.2d 367, 373 (9th Cir. 1990) (citing Ascon
17 Properties, Inc. v. Mobil Oil Co., 866 F.2d 1149, 1160 (9th Cir.
18 1989)).

19 It is disfavored to prevent a plaintiff from amending the
20 complaint at least once, and Defendant has not introduced any evidence
21 showing that amendment would be entirely futile. Accordingly,
22 Plaintiffs are granted 30 days to amend their Complaint and incorporate
23 plausible factual allegations showing that the SEC failed to conform to
24 its mandatory duties.

25 Plaintiffs are cautioned that an amended complaint supercedes a
26 previous complaint. See, e.g., Hal Roach Studios, Inc. v. Richard
27 Feiner & Co., 896 F.2d 1542, 1546 (9th Cir. 1990); see also Local Rule
28

1 15-2. When an amended complaint is filed, the previous complaint is
2 rendered null and void, and only the amended complaint remains legally
3 operable. Under this rule, "a plaintiff waives all causes of action
4 alleged in the original complaint which are not alleged in the amended
5 complaint." London v. Coopers & Lybrand, 644 F.2d 811, 814 (9th Cir.
6 1981). Accordingly, if Plaintiffs wish to preserve their original
7 arguments for appeal, Plaintiffs are advised to restate those
8 allegations in their amended complaint.²⁴ However, in order to expedite
9 future proceedings, the Court orders Plaintiffs to **clearly identify** any
10 modifications, additions, or deletions in their amended complaint.

11 While preparing the amended complaint, Plaintiffs are advised that
12 Fed. R. Civ. P. 11(b) requires that the factual allegations be made "to
13 the best of the person's knowledge, information, and belief, formed
14 after an inquiry reasonable under the circumstances." Obviously this
15 rule does not require Plaintiffs' amended complaint to contain factual
16 support of the type required in a Rule 56 summary judgment motion. But
17 in the present context, in order for Plaintiffs' pre-filing "inquiry"
18 to be "reasonable under the circumstances," they are expected to make a
19 good faith examination of the publicly available documents and allege
20 **only** those facts that are reasonably likely to find evidentiary support
21 during discovery. Plaintiffs shall refrain from submitting additional
22 conclusory allegations regarding unnamed "policies and practices."
23 Plaintiffs shall also refrain from submitting new allegations that are
24

25
26 ²⁴Given the voluminous nature of the original complaint, the Court grants
27 Plaintiffs permission to incorporate their original allegations by reference
28 into the amended complaint. The Court anticipates, however, that the "law
of the case" doctrine may preclude reconsideration of the specific
allegations addressed in the present Order. See, e.g., United States v.
Smith, 389 F.3d 944, 948-50 (9th Cir. 2004).

1 | contradicted by facts stated in any of the SEC's Office of Inspector
2 | General reports unless Plaintiffs can also plausibly allege that such
3 | reports are inaccurate or incomplete. Plaintiffs shall identify, to
4 | the best of their ability, the specific type of conduct governed by the
5 | alleged policies and the specific time period during which the policies
6 | were effective.

7 | Plaintiffs are advised that if they are unable to make a
8 | sufficient good faith inquiry within 30 days, their action will be
9 | dismissed without prejudice for lack of subject matter jurisdiction.
10 | See Frigard v. United States, 862 F.2d 201, 204 (9th Cir. 1988) (per
11 | curiam); Fed. R. Civ. P. 41(b). Because dismissal for lack of subject
12 | matter jurisdiction is ordinarily without prejudice, Plaintiffs may not
13 | necessarily be barred from reinstating the action in the future. See
14 | Wright & Miller, Federal Practice & Procedure § 1350 & nn. 61-62
15 | (collecting cases).

16 | ///
17 | ///
18 | ///

19 |
20 |
21 |
22 |
23 |
24 |
25 |
26 |
27 |
28 |

1 **VII. CONCLUSION**

2
3 Accordingly, Defendants' Motions to Dismiss for lack of subject
4 matter jurisdiction are GRANTED. Plaintiffs may file an amended
5 complaint containing new allegations that are reasonably aimed at
6 satisfying Plaintiffs' burden as described in this Order. If
7 Plaintiffs choose to file an amended complaint, the amended complaint
8 must be filed within 30 days of the date that this Order is entered on
9 the docket. Should Plaintiffs fail to file an amended complaint, the
10 action will be dismissed without prejudice for lack of subject matter
11 jurisdiction.

12
13
14 IT IS SO ORDERED.

15
16
17 DATED: April 20, 2010



18
19
20 STEPHEN V. WILSON
21 UNITED STATES DISTRICT JUDGE
22
23
24
25
26
27
28