UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PHYLLIS MOLCHATSKY and STEVEN SCHNEIDER, M.D., Plaintiffs, v. UNITED STATES OF AMERICA, Defendant.	09 CIV 8697 (LTS/AJP)

UNITED STATES OF AMERICA'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION TO DISMISS

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INTRODUCTION

Operating a massive Ponzi scheme, Bernard L. Madoff stole billions of dollars from thousands of investors, including charities, pension funds, universities, and individuals. Plaintiffs, two of Madoff's investors, brought this suit under the Federal Tort Claims Act seeking to recover their losses not from Madoff, but from the United States, based on the SEC's allegedly negligent investigations of Madoff's wrongdoing.

But the manner in which the SEC investigates suspected violations of the securities laws is grounded in policy and committed to the SEC's discretion by Congress. Decisions made in the course of such investigations are therefore shielded from liability by the discretionary function exception to the FTCA. Indeed, how to staff cases, which leads to pursue, and from what sources to obtain evidence—decisions made in the course of *every* investigation—are classic discretionary judgments that courts have traditionally refused to second-guess.

Even assuming that the SEC acted negligently in the course of its Madoff investigations, the discretionary function exception would still apply. Investigations are conducted to assist the SEC in deciding whether to commence civil proceedings against suspected wrongdoers. Those decisions, like prosecutors' decisions whether to charge criminal suspects, are quintessentially discretionary and subject to policy considerations. The discretionary function exception protects *all* such decisions, and therefore bars Plaintiffs' claims, regardless of whether the SEC's investigations were performed negligently.

Plaintiffs' losses are undeniably tragic. And, for the purpose of this motion, the Court may assume that they were preventable—if only the SEC had shut down Madoff's scheme; or if only it had employed better-qualified and more-experienced investigators, been more persistent

in its pursuit of the facts, or devoted additional time and resources to its examinations. In enacting the discretionary function exception, however, Congress made clear its intent that courts not use FTCA lawsuits to revisit such judgment calls by federal agencies. This lawsuit must therefore be dismissed for lack of subject-matter jurisdiction.

FACTS[1]

Over a period of years, the SEC received several complaints that Madoff was running a Ponzi scheme.[2] Plaintiffs contend that although the SEC investigated these allegations of wrongdoing by Madoff, its investigations were performed so negligently that the SEC failed to appreciate what Madoff was up to and the need to stop him.

The SEC's negligence, according to Plaintiffs, took many forms. "Inquiries were delegated from SEC teams that had expertise in financial fraud to ones that did not."[3] "Critical

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[1] For purposes of this motion, the well-pleaded factual allegations of the Complaint are taken as true. *See Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1950 (2009) ("When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief.").

[2] Compl. ¶ 5.

[3] *Id.* ¶ 6; *see also, e.g.*, *id.* ¶ 43 (alleging that investigation was assigned to "staff who had no experience with Ponzi schemes"), ¶ 49 (alleging that "top SEC staffer at the meeting had 'zero comprehension' of what [a tipster] was explaining"), ¶ 51 (alleging that complaint was assigned to staffer who was "very ill-trained, uninformed about industry practices, did not understand financial instruments . . . [and who] [d]idn't even have a basic understanding of finance"), ¶ 55 (alleging that complaint was assigned to staffer "who had never handled a Ponzi-scheme investigation and had no understanding of options trading, an integral part of Madoff's purported strategy"), ¶ 86 (alleging that complaint was transferred "from the Investment Management team to the Broker-Dealer team in the SEC's Washington, D.C. office, when the former had relevant experience, and the latter did not"), ¶ 114 (alleging that complaint was transferred "from the Investment Management team to the Broker-Dealer team, when the former had relevant experience, and the latter did not"), ¶ 153 (alleging that case was transferred "from the Boston

tasks were assigned to junior staffers who had no relevant training or experience."[4] Procedures for tracking and planning investigations were ignored.[5] Investigators failed to contact third parties to attempt to verify Madoff's claims.[6] "Petty jealousies and inter-office rivalries led to tipsters being disregarded and key resources of other SEC teams going unutilized."[7] Staff were

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Broker-Dealer team to the New York Enforcement team, when the former had relevant experience and history with Madoff, and the latter did not").

[4] *Id.* ¶ 6; *see also, e.g.*, *id.* ¶ 35 ("Both examiners assigned to the case were only 2 years out of college, and had no expertise or understanding of how Ponzi schemes operated."), ¶ 70 (alleging that staffers "'weren't familiar with securities laws'"), ¶ 124 (alleging that "the lion's share of the work was assigned to a junior staff attorney who had only recently graduated from law school and joined the SEC nineteen months before the referral"), ¶ 145 ("But the staffer apparently was too inexperienced to understand that she had already caught Madoff in serious wrongdoing, and simply disregarded the commingling, which, if pursued, would itself have inevitably brought down the scheme."), ¶ 150 (alleging that "junior staffer's inexperience and incompetence" resulted in discovery of "nothing but a red herring"), ¶ 153 (alleging that "principal duties" were assigned "to a junior staffer with no experience with Ponzi schemes").

[5] *Id.* ¶ 6; *see also, e.g.*, *id.* ¶ 109 (alleging that "the Washington team had never entered the opening of their case in the SEC's internal case tracking system" and that "the New York team never checked the system before launching its own investigation"), ¶ 114 (faulting SEC for failing "to draft a planning memorandum to direct the investigation").

[6] *Id.* ¶ 6; *see also, e.g.*, *id.* ¶ 9 (alleging "an agency culture of deference to powerful industry figures"), ¶ 38 ("Critically, the team did not make any effort to obtain any other information independently from third parties. . . ."), ¶ 43 (faulting SEC for failing to obtain records directly from the Depository Trust Corporation, "instead . . . requesting them from Madoff"), ¶ 75 (faulting SEC for failing to confirm Madoff's supposed trading activity with NASD), ¶ 80 ("Likewise, the team failed to consult the Chicago Board Options Exchange . . . despite the fact that the . . . complaint questioned whether any of the options trades Madoff was purportedly making through that exchange . . . had actually taken place."), ¶ 102 ("Moreover, the team never contacted any of Madoff's counterparties to see if he was actually trading with them."), ¶ 114 (alleging that SEC failed "to contact any other third parties to obtain confirmation of Madoff's claimed activities"), ¶ 153 (alleging failure "to ask DTC the size of Madoff's positions there").

[7] *Id.* ¶ 6; *see also, e.g.*, *id.* ¶ 68 ("The Broker-Dealer team never conferred with the Investment Management team for support or information . . . due to a pervasive atmosphere of jealousy and secrecy that prevented SEC teams from working together effectively."), ¶ 125 (alleging that tipster "inadvertently triggered a vendetta against himself by the supervisor, who would

"cowed" by Madoff's power and influence "into giving him the benefit of the doubt," despite their suspicions that he was lying.[8] And, finally, investigators failed to follow the right leads and missed obvious signs that Madoff was, in fact, duping his investors.[9] These mistakes, according to Plaintiffs, allowed Madoff "to pass through the SEC's investigations unscathed."[10]

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thereafter constantly denigrate him and the importance of the investigation"), ¶ 128 ("The supervisor was angry, embarrassed, and unwilling to acknowledge her own lack of expertise, and she ended up taking out her personal frustrations on [the tipster] and, in turn, on Madoff's victims."), ¶ 150 (blaming failed investigation on "supervisors' hostility towards" tipster).

[8] *Id.* ¶ 6; *see also, e.g.*, *id.* ¶ 35 (alleging that investigators "may have been overawed by Madoff," leading to a less rigorous examination), ¶ 103 (alleging that supervisor suspected Madoff was lying, but "was hesitant to make trouble for someone so 'well connected'"), ¶ 105 ("[S]upervisors . . . had become 'captive' regulators, who would turn a blind eye to the suspicious activities of industry heavyweights like Madoff, who they considered 'powerful and well connected,' rather than risk even the emptiest threats to their careers.").

[9] *See, e.g.*, *id.* ¶ 62 (faulting SEC staffer for failing to read articles, flagged by another staffer, that suggested fraud by Madoff), ¶¶ 72-73 (alleging that SEC negligently focused its investigation on "front-funning" rather than Madoff's Ponzi scheme), ¶ 74 (alleging that investigation failed to consider "numerous pertinent issues"), ¶ 84 (challenging SEC's priorities; "Supervisors determined that a new investigation probing mutual funds was more important than following up on Madoff, whom they already knew was accused of operating what was later discovered to be the largest Ponzi scheme in history."), ¶ 94 ("Once again . . . the supervising staff member decided, in knee-jerk fashion, to focus the inquiry exclusively on front-running."), ¶ 132 ("Just as the earlier investigations had focused on front-running instead of the Ponzi-scheme scenario, the Enforcement team focused almost exclusively on determining whether Madoff should register as an investment adviser or whether Madoff's hedge fund investors' disclosures were adequate. This focus clearly ignored the [inquiry's] initial designation . . . of a 'fraud investigation.'"), ¶ 135 ("The Enforcement team never followed up."), ¶ 146 (accusing SEC of "utterly failing to follow up obvious and necessary areas of further inquiry").

[10] *Id.* ¶ 5.

ARGUMENT

The Court must dismiss this case for lack of subject-matter jurisdiction, as Plaintiffs' claims are barred by the discretionary function exception to the FTCA.

The United States is immune from liability absent its consent, and the terms of that consent define a court's jurisdiction to entertain a suit against the United States.[11] The "'limitations and conditions upon which the Government consents to be sued must be strictly observed and exceptions thereto are not to be implied.'"[12] Thus, at the outset of a case against the United States, the court must determine whether the United States has waived its immunity. Absent a specific waiver, sovereign immunity bars suit for lack of subject-matter jurisdiction.[13] The burden to establish jurisdiction rests squarely on the plaintiffs, as the party asserting it.[14]

The FTCA is a limited waiver of sovereign immunity; subject to several exceptions, it authorizes suits against the United States for damages "caused by the negligent or wrongful act or omission of any employee of the Government."[15] The discretionary function exception is one of the exceptions. It provides that the United States may not be held liable "based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be

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[11] *United States v. Mitchell*, 445 U.S. 535, 538 (1980).

[12] *Lehman v. Nakshian*, 453 U.S. 156, 161 (1981) (quoting *Soriano v. United States*, 352 U.S. 270, 276 (1957)).

[13] *FDIC v. Meyer*, 510 U.S. 471, 475-76 (1994).

[14] *Kokkonen v. Guardian Life Ins. Co.*, 511 U.S. 375, 377 (1994).

[15] 28 U.S.C. § 1346(b); *see also* 28 U.S.C. § 2674 ("The United States shall be liable . . . in the same manner and to the same extent as a private individual under like circumstances. . . .").

abused."[16] "If a claim falls within this exception, the court lacks jurisdiction to entertain the claim."[17]

In determining whether the discretionary function exception applies, the appropriate inquiry is "whether the challenged acts . . . are of the nature and quality that Congress intended to shield from tort liability."[18] To assist in this determination, the Supreme Court has prescribed a two-part test. First, the challenged conduct must involve an "element of judgment or choice."[19] "This inquiry is mandated by the language of the exception; conduct cannot be discretionary unless it involves an element of judgment or choice. Thus, the discretionary function exception will not apply when a federal statute, regulation, or policy specifically prescribes a course of action for an employee to follow."[20] Second, the conduct must involve considerations of public policy.[21] After all, "[t]he basis for the discretionary function exception was Congress' desire to 'prevent judicial "second-guessing" of legislative and administrative decisions grounded in

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[16] 28 U.S.C. § 2680(a); *see also In re "Agent Orange" Prod. Liab. Litig.*, 818 F.2d 210, 215 (2d Cir. 1987) ("[W]here . . . the Government is performing a discretionary function, the fact that discretion is exercised in a negligent manner does not make the discretionary function exception inapplicable.").

[17] *Fazi v. United States*, 935 F.2d 535, 537 (2d Cir. 1991).

[18] *United States v. Varig Airlines*, 467 U.S. 797, 813 (1984).

[19] *See United States v. Gaubert*, 499 U.S. 315, 328-29 (1991); *Berkovitz v. United States*, 486 U.S. 531, 536 (1988); *In re World Trade Ctr. Disaster Site Litig.*, 521 F.3d 169, 195 (2d Cir. 2008).

[20] *Berkovitz*, 486 U.S. at 536 (citation omitted); *see also Gaubert*, 499 U.S. at 324; *Fazi*, 935 F.2d at 538; *In re World Trade Ctr.*, 521 F.3d at 195.

[21] *See Gaubert*, 499 U.S. at 332; *Berkovitz*, 486 U.S. at 537; *In re World Trade Ctr.*, 521 F.3d at 195.

social, economic, and political policy through the medium of an action in tort.'"[22] In making this second determination, "it is unimportant whether the government actually balanced economic, social, and political concerns in reaching its decision."[23] The relevant question is whether the decision is "*susceptible to* policy analysis."[24]

Application of this two-part test requires the Court to hold that the discretionary function exception bars Plaintiffs' claims. As the Supreme Court has observed, "whatever else the discretionary function exception may include, it plainly was intended to encompass the discretionary acts of the Government acting in its role as a regulator of the conduct of private individuals."[25]

I. The challenged actions involve elements of judgment.

The first part of the Supreme Court's test is satisfied because the challenged actions involve matters committed to the SEC's discretion. Under the 1934 Securities Exchange Act, the SEC has complete discretion in deciding whether, and to what extent, it should investigate suspected violations of the securities laws. The Act specifically provides that "[t]he Commission *may, in its discretion,* make such investigations *as it deems necessary* to determine whether any

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[22] *Berkovitz*, 486 U.S. at 536-37 (quoting *Varig Airlines*, 467 U.S. at 814).

[23] *In re Joint E. & S. Dists. Asbestos Litig.*, 891 F.2d 31, 37 (2d Cir. 1989).

[24] *Gaubert*, 499 U.S. at 325 (emphasis added); *see also In re Joint E. & S. Dists. Asbestos Litig.*, 891 F.2d at 37 (holding that relevant question is "'whether the decision is *susceptible to* policy analysis'") (emphasis added) (quoting *United States Fidelity & Guar. Co. v. United States*, 837 F.2d 116, 121 (3d Cir. 1988)).

[25] *Varig Airlines*, 467 U.S. at 813-14.

person has violated, is violating, or is about to violate [the securities laws]."[26] The Act further provides that the SEC "is authorized *in its discretion* . . . to investigate any facts, conditions, practices, or matters *which it may deem necessary or proper* to aid in the enforcement of such provisions."[27] The SEC enjoys similar discretion in its examinations of brokers, dealers, and investment advisors.[28] Based on this sweeping grant of authority, federal courts uniformly dismiss FTCA lawsuits challenging decisions by the SEC to investigate (or not) allegations of wrongdoing.[29]

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[26] 15 U.S.C. § 78u(a)(1) (emphasis added); *see also Sprecher v. Von Stein,* 772 F.2d 16, 18 (2d Cir. 1985) (holding that officials "undertaking an investigation authorized by the federal securities laws" were "performing discretionary functions"); *Sprecher v. Graber*, 716 F.2d 968, 974 (2d Cir. 1983) (recognizing that "SEC investigations" and the "issuance of subpoenas" are discretionary under the Act); *Levy v. United States*, No. 91-15490, 1992 WL 25450, at *1 (9th Cir. Feb. 14, 1992) ("Thus, from the plain language of the statute, investigations are to be performed at the discretion of the SEC."); *Bd. of Trade of Chicago v. SEC*, 883 F.2d 525, 531 (7th Cir. 1989) (recognizing that "[i]nvestigation" under the act is "discretionary, not mandatory"); *SEC v. Better Life Club of Am.*, 995 F. Supp. 167, 180 (D.D.C. 1998) ("Investigation . . . under [the Act] is discretionary. . . .").

[27] 15 U.S.C. § 78u(a)(1) (emphasis added).

[28] *See, e.g.*, 15 U.S.C. 78q(a) & (b)(1) ("All records of [brokers and dealers] are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission . . . as the Commission . . . deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title."); 15 U.S.C. 80b-4(a) ("All records . . . of . . . investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors.").

[29] *See, e.g., Levy*, 1992 WL 25450, at *1 (affirming dismissal of FTCA claim challenging SEC's decision not to investigate third party); *Standifer v. SEC*, 542 F. Supp. 2d 1312, 1318 (N.D. Ga. 2008) ("The SEC is granted broad discretion by Congress to investigate possible violations of the securities laws and to determine whether to bring civil or criminal actions to remedy those violations. The FTCA does not apply to Plaintiffs' claims.") (citation omitted); *Le v. SEC*, 542 F. Supp. 2d 1318, 1324 (N.D. Ga. 2008) (same); *Better Life Club*, 995 F. Supp. at 180 (dismissing FTCA counterclaims based on SEC's decision to investigate); *Leytman v. NYSE*,

The decision in *Levy v. United States* is particularly pertinent. There, the plaintiff brought an FTCA lawsuit challenging the SEC's failure to investigate and disclose the insolvency of a third-party corporation.[30] The plaintiff later acquired that corporation, "thereby incurring significant damages."[31]

In affirming the district court's dismissal, the court of appeals quoted the FTCA's legislative history to support two points. First, the court noted that the discretionary function exception, according to the legislative history, was "'designed to preclude application of the [FTCA] to a claim based upon an alleged abuse of discretionary authority by a regulatory or licensing agency—for example, the . . . *Securities and Exchange Commission*.'"[32] Thus, Congress specifically noted that the SEC's discretionary authority as a regulatory agency falls within the scope of the discretionary function exception. Second, the court quoted the statement in the legislative history that it was "'neither desirable nor intended that the . . . propriety of a discretionary administrative act should be tested through the medium of a damage suit for

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No. 95 CV 902, 1995 WL 761843, at *3 (E.D.N.Y. Dec. 6, 1995) ("The decision of whether or not to investigate . . . is left in the discretion of the Commission. Even if the Commission abuses that discretion, the court may not intervene."); *cf. Redmond v. United States*, 518 F.2d 811, 814-17 (7th Cir. 1975) (affirming dismissal, based on misrepresentation exception, of FTCA lawsuit based on SEC's failure to warn plaintiff before he was defrauded by securities dealer; holding that "how best to fulfill" the government's "duty to maintain law and order . . . is wholly within the discretion of its officers, and [28 U.S.C. § 2680(a)] excepts from the [FTCA] both discretionary functions and discretionary duties").

[30] 1992 WL 25450, at *1.

[31] *Id.*

[32] *Id.* at *2 (quoting Hearings on H.R. 5373 and H.R. 6463 before the H. Comm. on the Judiciary, 77th Cong. 28, 33 (1942) (statement of Assistant Attorney General Francis M. Shea)) (emphasis added).

tort.'"[33] Based on this legislative history, and on the robust discretion provided to the SEC by the 1934 Act, the court concluded that the SEC's failure to investigate and disclose the insolvency of a third party "was precisely the kind of conduct" that the discretionary function exception was intended to protect.[34]

The discretionary function exception covers not only the *extent* to which the SEC investigated Madoff, but also the *manner* in which it investigated him. Indeed, courts have long recognized that "the sifting of evidence, the weighing of its significance, and the myriad other decisions made during investigations plainly involve elements of judgment and choice."[35]

In their Complaint, Plaintiffs seek to avoid the discretionary function exception by alleging that "the SEC staff who investigated Madoff . . . were not crafting policy or making rules[, but were] carrying out their usual and regular obligations."[36] But Plaintiffs' suggestion that investigators' day-to-day activities are not protected by the discretionary function exception is contradicted by precedent. As the Second Circuit has recognized, "the discretionary function

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[33] *Id.*

[34] *Id.*

[35] *Sloan v. HUD*, 236 F.3d 756, 762 (D.C. Cir. 2001); *see also Wang v. United States*, 61 Fed. Appx. 757, 759 (2d Cir. 2003) (holding that conduct of investigative agents "involving an element of discretion, which discretion is based on 'considerations of public policy,' is bulletproof from liability under the operative discretionary function exception") (citation omitted); *Hobdy v. United States*, 762 F. Supp. 1459, 1462 (D. Kan. 1991) ("[T]o the extent that plaintiff seeks to challenge the manner or thoroughness of the . . . investigation, plaintiff's claim is barred by the discretionary function exception."); *Bradley*, 615 F. Supp. at 209 ("Deciding how to investigate, who to investigate, and how to present evidence to the proper authorities are classic examples of immunized prosecutorial conduct.").

[36] Compl. ¶ 3; *see also id.* ¶ 14 ("The misconduct of the SEC staff had nothing to [do] with rule-making or policy analysis and implementation.").

exception bars claims based on day-to-day management decisions if those decisions require judgments as to which of a range of permissible courses is wisest."[37]

During its Madoff investigations, the SEC was regularly required to make such decisions. There was no statute, regulation, or mandatory directive that compelled the assignment of a particular investigation to a particular "team." Nor was there any mandate that the SEC employ investigators with certain qualifications or levels of experience. There was no requirement that SEC staffers seek documents or information from sources other than Madoff; indeed, the 1934 Act expressly provides that the SEC "*may* require . . . *any* person to file with it a statement in writing, under oath or otherwise *as the Commission shall determine*, as to all the facts and circumstances concerning the matter to be investigated."[38] Finally, there was no statute, regulation, or mandatory policy that required the SEC to follow one lead over another, or to investigate one aspect of alleged wrongdoing in addition to others. Again, the 1934 Act specifically authorizes the SEC, "*in its discretion* . . . to investigate *any* facts, conditions, practices, or matters *which it may deem* necessary or proper. . . ."[39]

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[37] *Fazi*, 935 F.2d at 538; *see also Gaubert*, 499 U.S. at 325 ("A discretionary act is one that involves choice or judgment; there is nothing in that description that refers exclusively to policymaking or planning functions. Day-to-day management of banking affairs, like the management of other businesses, regularly requires judgment as to which of a range of permissible courses is the wisest. Discretionary conduct is not confined to the policy or planning level."); *Varig Airlines*, 467 U.S. at 813 ("[I]t is the nature of the conduct, rather than the status of the actor, that governs whether the discretionary function exception applies in a given case.").

[38] 15 U.S.C. § 78u(a)(1) (emphasis added).

[39] *Id.* (emphasis added); *cf. Treats Int'l Enters. v. SEC*, 828 F. Supp. 16, 18 (S.D.N.Y. 1993) (holding that statutes and regulations pertaining to SEC supply no "judicially manageable standards for judging how and when the SEC should exercise its discretion to investigate possible securities violations").

Further, the SEC conducts its investigations to inform its decision whether to commence civil proceedings against suspected violators—a decision that is unquestionably committed to its discretion. Indeed, the 1934 Act specifically provides that "[w]henever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of [the securities laws], it *may in its discretion* bring an action in the proper district court of the United States . . . to enjoin such acts or practices."[40] The plain language of the Act thus establishes that the SEC's failure to seek injunctive relief against Madoff, for whatever reason, was discretionary.[41]

Because the ultimate decision whether to commence civil proceedings against Madoff was wholly within the SEC's discretion, the discretionary function exception bars Plaintiffs' claims, even if the SEC's decision was based on flawed information or faulty investigative

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[40] 15 U.S.C. § 78u(d)(1) (emphasis added).

[41] *See, e.g.*, *Bd. of Trade*, 883 F.2d at 531 (recognizing that prosecution under the Act is "discretionary, not mandatory"); *id.* at 530 ("Refusal to prosecute is a classic illustration of a decision committed to agency discretion."); *Better Life Club*, 995 F. Supp. at 180 (holding that "prosecution under [the Act] is discretionary"); *cf. Wright v. United States*, 719 F.2d 1032, 1035 (9th Cir. 1983) ("The decision whether or not to prosecute a given individual is a discretionary function for which the United States is immune from liability."); *Gray v. Bell*, 712 F.2d 490, 513 (D.C. Cir. 1983) ("Prosecutorial decisions as to whether, when and against whom to initiate prosecution are quintessential examples of governmental discretion in enforcing the criminal law, and, accordingly, courts have uniformly found them to be immune under the discretionary function exception."); *Bradley v. United States*, 615 F. Supp. 206, 209 (E.D. Pa. 1985), *aff'd sub nom. Pooler v. United States*, 787 F.2d 868 (3d Cir. 1986) ("The decision to prosecute a given individual is the quintessential example of discretionary conduct. That prosecutors possess wide latitude in this regard has never been questioned and the reasons supportive of its existence have often been used to analyze the availability of the discretionary function exception in similar FTCA situations.") (citations omitted).

techniques. Two decisions are particularly illustrative of this point.[42]

In *Fisher Bros. Sales, Inc. v. United States*, the FDA received information from an anonymous caller that fruit imported from Chile had been injected with cyanide.[43] The FDA took steps to see if there was any tainted fruit, and an FDA laboratory concluded that a couple of grapes were tainted.[44] Based on the information before him, including the laboratory report, the FDA Commissioner exercised his discretion to refuse entry of any Chilean fruit into the United States and to withdraw all such fruit already in domestic distribution channels, causing the plaintiffs to suffer significant losses.[45]

Recognizing that they could not attack the Commissioner's discretionary decisions to ban and remove the fruit, the plaintiffs instead alleged that the "laboratory's tests were negligently performed because the procedures used conformed neither to the FDA's Regulatory Procedures Manual nor to good laboratory practices generally."[46] But the court rejected this characterization of the case and held that plaintiffs may not "by the manner in which they draft their complaints . . . dictate that their claims are 'based upon' one government employee's actions and not another's."[47] The court concluded:

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[42] *See Fisher Bros. Sales, Inc. v. United States*, 46 F.3d 279, 282 (3d Cir. 1995) (en banc); *Gen. Dynamics Corp. v. United States*, 139 F.3d 1280, 1283 (9th Cir. 1998).

[43] 46 F.3d at 282.

[44] *Id.* at 282-83.

[45] *Id.* at 283.

[46] *Id.* at 285-86.

[47] *Id.* at 286; *see also Gen. Dynamics*, 139 F.3d at 1283 ("Courts are not required to, and should not, simply look at the surface of a complaint for the purpose of ascertaining the true basis

> The reality here is that the injuries of which the plaintiffs complain were caused by the Commissioner's decisions and, as a matter of law, their claims are therefore "based upon" those decisions. Any other view would defeat the purpose of the discretionary function exception. In situations like this where the injury complained of is caused by a regulatory policy decision, the fact of the matter is that there is no difference in the quality or quantity of the interference occasioned by judicial second guessing, whether the plaintiff purports to be attacking the data base on which the policy is founded or acknowledges outright that he or she is challenging the policy itself.[48]

Similarly, in *General Dynamics Corporation v. United States*, government auditors negligently reported that General Dynamics had committed fraud in the course of performing a government contract.[49] Based on that report, the Department of Justice initiated criminal and civil litigation against the corporation. Upon learning that the auditors' report was flawed, the government dropped the charges, but General Dynamics then brought its own lawsuit under the FTCA based on the negligently prepared audit.

The court began with the observation that "no one doubts that prosecutorial discretion is covered" by the discretionary function exception.[50] It then recognized General Dynamics' complaint for what it was—an attempt to circumvent the discretionary function exception by "postur[ing] its case as an attack on the [auditors] rather than as an attack on the prosecutors."[51] The court rejected this "ancient tactic":

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of an attack upon something the government has done.").

[48] *Fisher Bros.*, 46 F.3d at 286.

[49] 139 F.3d at 1282.

[50] *Id.* at 1283.

[51] *Id.*

> designation of targeted employees. . . . We may take cognizance of the fact that a target has been selected for the purpose of evading the discretionary choice of the persons who actually caused the damage—here the prosecutors, who were pushing a criminal (and civil) attack upon General Dynamics and its employees.[52]

The court concluded that where "the harm actually flows from the prosecutor's exercise of discretion, an attempt to recharacterize the action" as one for negligent investigation "must fail."[53]

In *Fisher Bros.* and *General Dynamics*, the courts held that plaintiffs may not avoid dismissal by looking behind discretionary, injury-causing decisions and arguing instead that their claims are really "based upon" separate, non-discretionary acts. Likewise, here, Plaintiffs cannot circumvent the discretionary function exception by focusing on the SEC's investigative techniques rather than the ultimate, discretionary decision whether to prosecute Madoff. Simply put, the discretionary function exception bars Plaintiffs' suit because it is, at bottom, "based upon" a discretionary act—the failure to commence civil proceedings to stop Madoff.

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[52] *Id.*

[53] *Id.* at 1286; *see also Franklin Sav. Corp. v. United States*, 180 F.3d 1124, 1132 n.11 (10th Cir. 1999) ("To allow plaintiffs to avoid the discretionary-function bar by alleging that RTC employees breached a specific duty to report information, even though the harmful decisions based on the information were themselves discretionary, would be in tension with precedent."); *Johnson v. United States*, 949 F.2d 332, 339-40 (10th Cir. 1991) (applying discretionary function exception to bar claim challenging agency's "information gathering activity," which was mandatory, because it was "inextricably tied to" and "a component of the overall policy decision," which was discretionary); *Myslakowski v. United States*, 806 F.2d 94, 97 (6th Cir. 1986) ("[E]ven the negligent failure of a discretionary government policymaker to consider all relevant aspects of a subject matter under consideration does not vitiate the discretionary character of the decision that is made."); *Jayvee Brand, Inc. v. United States*, 721 F.2d 385, 389 (D.C. Cir. 1983) (**"**[M]aking a discretionary decision without following mandated procedures should be characterized, for the purposes of the FTCA, as an abuse of discretion. It follows that the discretionary function exception applies and the district court was without jurisdiction to entertain this suit.").

Because both the SEC's investigations of Madoff and its ultimate decision whether to prosecute him were committed to the SEC's discretion, the first part of the discretionary function test is met.

II. The challenged actions are susceptible to policy analysis.

The second part of the discretionary function test is met because each of the challenged actions is susceptible to policy analysis. Whether to commence an investigation and, ultimately, civil proceedings against a suspected violator of the securities laws involves classic considerations of how best to use limited agency resources. As Judge Easterbrook, writing for the court in *Board of Trade v. SEC*, observed:

> Doing nothing may be the most constructive use of the Commission's resources. Congress gives the SEC a budget, setting a cap on its personnel. With limited numbers of staff-years, the Commission must enforce several complex statutes. To do this intelligently the Commissioners must assign priorities. Prosecuting [one suspected wrongdoer] means less time for something else—investigating claims of fraud in issuing new stock or conducting a takeover contest, resolving disputes under the Investment Company Act, and so on. Agencies may find it worthwhile to give short shrift to a particular claim if the aggrieved party can file its own suit . . . , for turning the subject over to private litigation frees up time without necessarily diminishing the enforcement of the statute. Yet even when the aggrieved party cannot vindicate its own rights, . . . even when the person complaining about failure to prosecute is a defendant whose business is going down the tubes—decisions about the best use of the staff's time are for the prosecutor's judgment.[54]

Moreover, these decisions are better made by federal agencies than courts, which are constrained by the particular allegations in the cases they consider.

> Courts cannot intelligently supervise the Commission's allocation of its staff's time, because although judges see clearly the claim the Commission has

[54] 883 F.2d at 531 (citations omitted).

> declined to redress, they do not see at all the tasks the staff may accomplish with the time released. Agencies must compare the value of pursuing one case against the value of pursuing another; declining a particular case hardly means that the SEC's lawyers and economists will go twiddle their thumbs; case-versus-case is the daily tradeoff. Judges compare the case at hand against a rule of law or an abstract standard of diligence and do not see the opportunity costs of reallocations within the agency. That fundamental difference in the perspectives of the two bodies is why agencies (and other prosecutors) rather than courts must make the decisions on pursuing or dropping claims. Resource allocation is not a task governed by "law." It is governed by budgets and opportunities. Agencies "take Care that the Laws be faithfully executed" by doing the best they can with the resources Congress allows them. Judges could make allocative decisions only by taking over the job of planning the agency's entire agenda, something neither authorized by statute nor part of their constitutional role.[55]

The SEC's decision whether to seek injunctive relief against Madoff is plainly susceptible to these policy considerations. So, too, is the manner in which the SEC investigated Madoff. "Investigations by federal law enforcement officials . . . clearly require investigative officers to consider relevant political and social circumstances in making decisions about the nature and scope of a criminal investigation."[56] The challenged conduct here—for example, whether to refer

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[55] *Id.* (citations omitted).

[56] *Sabow v. United States*, 93 F.3d 1445, 1453 (9th Cir. 1996); *see also Valdez v. United States*, No. 08 Civ. 4424(RPP), 2009 WL 2365549, at *6 (S.D.N.Y. July 31, 2009) (holding that second part of test was satisfied because "a DEA agent's decision to conduct an investigation in a particular manner is subject to several policy considerations"); *id.* at *7 ("Plaintiff[] claims that Agent Mercurio was negligent and reckless in failing to interview Gil, conduct a line-up, show Gil a photo-array, or otherwise further investigate Plaintiff's claims of mistaken identity. These kinds of decisions about how to conduct investigations fall squarely within the discretionary function exception."); *Woods v. United States*, Civ. Action No. 07-593 (DMC), 2007 WL 3243852, at **3-4 (D.N.J. Nov. 1, 2007) ("The second prong of the test for the discretionary function exception is also satisfied because public policy considerations are involved. How a government agent should conduct an investigation is the paradigm decision that is protected by the discretionary function exception."); *Rourke v. United States*, 744 F. Supp. 100, 103 (E.D. Pa. 1988) ("[T]o the extent that Rourke seeks compensation for having been erroneously arrested and charged due to a flawed investigation, the discretionary function exception precludes the claims against the government in that the manner of conducting an investigation . . . [is] the kind of 'quintessentially' discretionary activit[y] for which sovereign immunity has not been waived.").

a complaint to a particular investigative team, to obtain evidence from one source or another, or to assign significance to a specific fact—are all decisions that are susceptible to policy analysis.

"[W]hen the sole complaint [in a lawsuit] is addressed, as here, to the quality of the investigation as judged by its outcome, the discretionary function [exception] should . . . and . . . does apply. Congress did not intend to provide for judicial review of the quality of investigative efforts."[57]

Because both the SEC's investigations of Madoff and its ultimate decision whether to prosecute him are susceptible to policy analysis, the second part of the discretionary function test is met.

[57] *Pooler*, 787 F.2d at 871.

CONCLUSION

The challenged conduct in this case is committed to the SEC's discretion and grounded in policy. Plaintiffs' suit is therefore barred by the discretionary function exception, and the Court must dismiss it for lack of subject-matter jurisdiction.

Respectfully submitted,

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