NOS. 04-1242, 05-1145

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

THE FINANCIAL PLANNING ASSOCIATION,
Petitioner,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
Respondent

On Petition for Review of Final Rule of the
United States Securities and Exchange Commission

BRIEF OF AMICI CURIAE OF FUND DEMOCRACY, INC. AND CONSUMER FEDERATION OF AMERICA IN SUPPORT OF PETITIONER

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CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

Pursuant to District of Columbia Cir. R. 28(a)(1), the undersigned counsel for *Amici Curiae* Consumer Federation of America and Fund Democracy, hereby certifies the following:

A. Parties and *Amici*. All parties and *amici* are listed in the brief for the Petitioner.

B. Rulings Under Review. References to the rulings at issue appear in the Brief for Petitioner.

C. Related Cases. No court has previously reviewed this Rule.

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Pursuant to FRAP 26.1 and Circuit Rule 26.1(a):

No corporation or any other entity owns more than 10% of the stock of the Consumer Federation of America, which is a nonprofit membership association.

No corporation or any other entity owns more than 10% of the stock of Fund Democracy, Inc., which is a nonprofit membership organization.

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GLOSSARY

Advisers Act	Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 through 80b-21
APA	Administrative Procedure Act, Pub. L. No. 79-404, 60 Stat. 237 (1946) (codified as amended in scattered sections 5 and 7 U.S.C.)
Brochure Rule	17 C.F.R. § 275.204-3 (written disclosure statements)
Broker Exemption	17 C.F.R. § 275.202(a)(11)-1, *published* 70 Fed. Reg. 20,424 (Apr. 19, 2005)
Commission or SEC	United States Securities and Exchange Commission
Exchange Act	Securities Exchange Act of 1934, 15 U.S.C. §§ 78a through 78mm
FPA	Financial Planning Association

INTEREST OF *AMICI CURIAE*

The Consumer Federation of America is a nonprofit association of approximately 300 national, state, and local consumer groups, which in turn represent approximately 50 million Americans. Fund Democracy, Inc. is a nonprofit advocacy group for mutual fund shareholders, whose members include employee, professional, consumer and investor groups representing tens of millions of Americans. Investors, including mutual fund shareholders frequently use the services of brokers to purchase securities, and the Broker Exemption is substantially and adversely affecting their interests. The Parties have been actively engaged in commenting on the broker exemption since 2000 through letters, articles, press releases and meetings with Commission staff and Commissioners.

The Parties' interests and the interest of the Financial Planning Association ("FPA") differ. The FPA's principal interest in this matter is the unfair competition to which the broker exemption will subject its member financial planners. The Parties' principal interest is the protection of investors and the harm to investors that is being caused by the Broker Exemption.

The FPA has consented to the Parties' participation as *amici curiae*, but the Securities & Exchange Commission has refused to consent. Accordingly, the Court's grant of leave to participate to the Parties constitutes the Parties' authority to file this brief.

ISSUES PRESENTED

1. Is the Broker Exemption arbitrary and capricious because the Commission failed to consider reasonable alternatives to a blanket exemption from an entire statutory scheme?

2. Is the Broker Exemption arbitrary and capricious because the Commission's interpretation of the term "solely incidental" bears no reasonable relationship to the plain meaning of that term?

The answer to both questions is yes.

SUMMARY OF ARGUMENT

For six years, the Commission considered its proposal to grant brokers and dealers who provide non-incidental investment advice a blanket exemption from the entire statute under which Congress specifically and expressly directed that they be regulated. Yet, the Commission failed to consider any alternatives that might have left at least some of the Advisers Act's investor protections intact. In the past, the Commission has granted numerous exemptions from specific provisions of the Act, but it decided in this case to completely ignore – without explanation – any approach short of a complete evisceration of the regulatory regime Congress created for investment advisers. Further, the Commission's stated reliance on the condition that exempt brokers provide "solely incidental" advice collapses under an SEC interpretation of that term that bears no rational relationship to its plain meaning. The Commission's failure to consider reasonable alternatives and its unreasonable interpretation of the term "solely incidental" render the Broker Exemption arbitrary and capricious in violation of the APA, 5 U.S.C. § 706.

ARGUMENT

I. THE COURT SHOULD GRANT THE PETITION FOR REVIEW BECAUSE THE BROKER EXEMPTION VIOLATES THE APA

Under the APA, courts must "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of agency discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). While the "scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency . . . the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)); *see Dickson v. Sec'y of Def.*, 68 F.3d 1396, 1404 (D.C. Cir. 1995) (same). An agency rule is arbitrary and capricious if the agency has "relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43.

We believe that the Broker Exemption is arbitrary and capricious for the reasons stated in Part IV of Petitioner's Brief. The Broker Exemption is also arbitrary and capricious, as discussed further below, because (1) the Commission did not consider

reasonable alternatives to a blanket exemption from the entire Advisers Act, and (2) the Commission's interpretation of the "solely incidental" condition is unreasonable.

A. The Broker Exemption is arbitrary and capricious because the Commission did not consider reasonable alternatives to a blanket exemption from the entire Advisers Act.

The Commission granted an exemption to an entire class of advisers from every provision of the Advisers Act while appearing to disregard reasonable alternatives and to abandon its longstanding practice of tailoring exemptions to the particular situation. Faced with reasonable alternatives to its proposed action, the SEC should have "consider[ed] those alternatives or give[n] some reason . . . for declining to do so." *Laclede Gas Co. v. FERC*, 873 F.2d 1494, 1498 (D.C. Cir. 1987) (emphasis removed).

The Commission need not consider "every alternative . . . conceivable by the mind of man…regardless of how uncommon or unknown that alternative" may be, *Motor Vehicles Mfrs. Assoc.*, 463 U.S. at 51 (quoting *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 (1978)), but it must consider obvious and reasonable alternatives, especially when such alternatives were expressly suggested in comment letters on its proposal and it has routinely adopted such reasonable alternatives in the past. *See Motor Vehicles Mfrs. Assoc.*, 463 U.S. at 48 (reasoning that "an agency must cogently explain why it has exercised its discretion in a given manner").

The Commission adopted the Broker Exemption because it was concerned "that the application of the Advisers Act to broker-dealers offering these new [fee-based] brokerage programs would discourage their development," 70 Fed. Reg. 20,425 – 26, citing claims by brokers that regulation under the Act would impose "a duplicative and unnecessary regulatory regime." *Id*. at 20,426 (citing comment letters from brokers).

Despite its repeated assertions that the Broker Exemption was necessary to avoid duplicative and unnecessary regulation,[1] the Commission does not discuss how any of the requirements of the Advisers Act are duplicative or unnecessary. The absence of any discussion of the duplicative or unnecessary requirements of the Advisers Act is evidence of the Commission's failure to consider reasonable alternatives to the blanket Broker Exemption.

For example, the SEC stated, as one justification for the Broker Exemption, that the "rule would preserve the ability of broker-dealers to engage in principal transactions with these fee-based brokerage customers." *Id*. at 20,426. Section 206(3) of the Advisers Act prohibits investment advisers from acting as principals in trades with clients without full disclosure of the capacity in which the investment adviser is acting and requires that advisers obtain the client's consent before each transaction. *See* 15 U.S.C. § 80b-6(3). The Commission fails to discuss how this principal transaction prohibition would be duplicative or unnecessary for brokers who were subject to the Advisers Act. Rather, the Commission simply states: that the Broker Exemption would have the effect of nullifying Congress's decision to protect recipients of investment advice from the conflict of interest presented when a broker sells securities to the client out of the broker's own inventory.

[1] *See* 70 Fed. Reg. 20,430 (stating that, "as drafted in 1940, the Advisers Act avoided additional and largely duplicative regulation of broker-dealers, which were regulated under provisions of the Exchange Act that had been enacted six years earlier." (footnote omitted)), 20,431 ("One of the reasons Congress enacted the broker-dealer exception was to avoid largely duplicative regulation."), 20,432 (". . . we believe the primary effect of [the Broker Exemption] will be to maintain the historic ability of full-service broker-dealers to provide a wide variety of services, including advisory services, to brokerage customers."); 20,433 (". . . we believe that the [Broker Exemption] is consistent with the statute's intent to avoid largely duplicative regulation of firms already subject to Commission oversight.").

Indeed, the Commission did not discuss how any of the requirements of the Advisers Act were "duplicative or unnecessary." The Act and the rules thereunder impose requirements relating to, among other things, generally fraudulent conduct, registration, disclosure, agency cross transactions, the keeping of books and records, advertisements, custody, client solicitations, proxy voting and compliance procedures. Yet the Commission does not discuss how these requirements are duplicative, burdensome or otherwise inappropriate requirements for brokers, apparently assuming an all-or-nothing approach to the perceived problem of subjecting certain brokers to the Advisers Act.

As the SEC's own past practice indicates, a complete exemption from the entire Act was not necessary to address potential adverse effects on brokers of the Act's requirements, such as Section 206(3)'s principal trading prohibition. For example, in 1975 the SEC adopted a rule that exempted brokers from the principal trading prohibition when the prohibition was triggered solely by reason of providing generalized investment advice in the form of publicly distributed or other general materials and statistical information. *See* 17 C.F.R. § 275.206(3)-1.

The SEC has routinely granted such exemptions from specific provisions of the Act in certain situations. For example, Section 206(3) of the Advisers Act, in addition to regulating principal trades, requires client approval for transactions in which the adviser also acts as broker on both sides of the trade ("agency cross transactions"). *See* 15 U.S.C. § 80b-6(3). The SEC has adopted a rule that permits brokers to obtain blanket approval of agency cross transactions under Section 206(3), rather than for each individual transaction. *See* 17 C.F.R. § 275.206(3)-2. Section 205(a)(1) of the Act generally

prohibits investment advisers from charging fees based on the investment performance of the account. *See* 15 U.S.C. § 80b-5(a)(1). Rule 205-3 under the Act exempts investment advisers from this provision to the extent that such performance-based compensation is charged only to certain qualified investors. *See* 17 C.F.R. § 275.205-3. Section 205(a)(2) of the Act requires client consent to the assignment of an advisory contract. *See* 15 U.S.C. § 80b-5(a)(2). Rule 202(a)(1)-1 under the Act provides an exemption for transactions that do "not result in a change of actual control or management of an investment adviser." 17 C.F.R. § 275.202(a)(1)-1.

The Commission similarly has broad authority to conform the registration and disclosure requirements of the Act to the particular circumstances. Section 203(c) of the Advisers Act provides that the registration required of investment advisers by Section 203(a) shall be accomplished by the filing of a registration application "as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors." *See* 15 U.S.C. § 80b-3. Thus, the Commission can by rule modify registration requirements that address the particular situation of brokers. *See*, *e.g.*, 17 C.F.R. §§ 275.203-1, 275.203(b)(3)-1, 275.203(b)(3)-2.

Rule 204-3, which requires that investment advisers deliver a disclosure document to their clients and is known as the Brochure Rule, provides an exemption for investment company clients and contracts for impersonal advisory services. *See* 17 C.F.R. § 275.204-3. The Commission does not mention this rule, nor does it consider whether creating a tailored exemption from the Brochure Rule would achieve the purpose of the Broker Exemption. It is difficult to understand how the Commission could devote a substantial part of its discussion of the Broker Exemption to the specific disclosures that

should be required of brokers without referencing the possibility of accomplishing such disclosure through a modification of the Brochure Rule or other disclosure requirements under the Advisers Act. *See* 70 Fed. Reg. 20,434-36. The Commission instead chose first to exempt brokers from the disclosure requirements of the Act, and second to recreate disclosure requirements for brokers from scratch. *See* 17 C.F.R. § 275.202(a)(11)-1(a) (requiring standardized disclosure that advisory account offered by broker is brokerage account).

Under Section 206(4), the Advisers Act's principal antifraud provision, the Commission has adopted rules addressing advertisements, custody, client solicitations, disclosure of financial and disciplinary information, proxy voting and compliance procedures. *See* 17 C.F.R. § 275.206(4)-1 (advertisements), 275.206(4)-2 (custody), 275.206(4)-3 (solicitations), 275.206(4)-4 (financial and disciplinary information), 275.206(4)-6 (proxy voting), 275.206(4)-7 (compliance procedures). To the extent that any of these rules might be unduly burdensome for brokers providing non-incidental or specially compensated advice, the Commission could easily have amended them. It chose instead not to address them.

The foregoing examples illustrate the SEC's longstanding practice of individually tailoring the requirements of the Act to specific circumstances, yet with the Broker Exemption it violated its own practice and thereby flouted fundamental APA requirements. Nowhere has the SEC mentioned or evaluated how brokers that provide non-incidental or specially compensated investment advice are affected by the Act's direct and indirect requirements regarding registration applications, principal transactions, agency cross transactions, performance-based fees, custody, client

solicitations, disclosure of financial and disciplinary information, proxy voting, compliance procedures, or any other requirements of the Advisers Act.[2]

The Commission has effectively conceded that it failed to consider reasonable alternatives to a blanket exemption from the Advisers Act by announcing its intention to conduct a study of "ways to address investor protection concerns arising from material differences between the [Advisers Act and Exchange Act] regulatory regimes." 70 Fed. Reg. 20,442. The Commission decided, only after it had adopted a rule that exempted most brokers from the entire Advisers Act, that it needed to answer questions such as:

- Should sales practice standards and advertising rules applicable to advice provided by broker-dealers be enhanced?
- Should broker-dealers who provide investment advice but who are excepted from the Investment Advisers Act nonetheless be subject to the fiduciary obligations imposed by that Act on investment advisers?

Id. If the Commission does not already have an answer to the question of whether brokers should be subject to advertising rules or fiduciary obligations under the Advisers Act, then how could it have reasonably decided to exempt brokers from those rules and obligations? These are precisely the kinds of questions that the APA requires the Commission to have answered before exempting brokers from the Advisers Act's requirements, yet it has decided to begin seeking answers to these questions only after adopting the Broker Exemption – ***more than six years after first proposing it***.[3] As its

[2] Although the Commission has excluded discretionary accounts and certain financial planning services from the reach of the Broker Exemption, it has not considered any reasonable alternatives to a blanket exemption for the vast majority of brokers who still may avail themselves of the rule.

[3] The Commission even seems uncertain of the questions that need to be answered. Since announcing in April 2005 its intent to conduct the study, the Commission has managed only to issue a release stating that, in fact, "a study will be commenced." Advisers Act Release No. 2492 (Mar. 3, 2006) at http://www.sec.gov/rules/other/34-53406.pdf (announcing intent to "compare the levels of protection afforded retail customers of financial service providers under the Securities Exchange Act and the

belated proposal demonstrates, the Commission appears to be adopting rules first, and asking questions and considering alternatives later.

A reason for the Commission's failure to consider reasonable alternatives to the Broker Exemption may be that there is no rational basis for such a blanket exemption. Indeed, there can be no rational basis for exempting brokers who provide personalized investment advice to advisory clients, for example, from the prohibition against "employ[ing] any device, scheme, or artifice to defraud any client or prospective client," 15 U.S.C. § 80b-6(1), even assuming that this provision of the Advisers Act (among others) does not cover any fraudulent conduct that would not already be prohibited under other federal laws applicable to brokers. But the notion that this provision does not prohibit conduct that would not otherwise be prohibited under the Exchange Act is only an assumption, and, we believe, an incorrect assumption at that. The Commission does not discuss, however, whether or how any of the requirements of the Advisers Act are duplicative or unnecessary, and it seems to intend only now to conduct a study to find whether its assumption has any basis. The Commission provides no support for its conclusory claim that regulation under the Advisers Act would be duplicative or unnecessary.

The Commission's failure here is strikingly similar to the facts in *Chamber of Commerce v. Securities and Exchange Commission*. 412 F.3d 133, 136 (D.C. Cir. 2005). In that case, this Court found that the Commission violated the APA by failing to consider, as an alternative to requiring that a mutual fund's chairman be independent, a requirement that the fund simply disclose whether its chairman is independent. As with

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Investment Advisers Act and to address any investor protection concerns arising from material differences between the two regimes").

the numerous Advisers Act exemptions discussed above, disclosure has been a longstanding alternative to broader measures. If the failure to consider the disclosure alternative in *Chamber of Commerce* violated the APA, then the failure to discuss any alternative short of a complete exemption from the Advisers Act violated the APA many times over. In *Chamber of Commerce*, the Commission merely proposed adding the requirement of an independent chairman to pre-existing exemptive rules, whereas in this instance it effectively repealed a statute as applied to an entire category of investment advisers. This Court noted in *Chamber of Commerce* that the use of disclosure is "a familiar tool in the Commission's toolkit." *Id*. at 145. As illustrated above, tailored exemptions to the requirements of the Advisers Act are also "a familiar tool in the Commission's toolkit," yet the Commission not only ignored this tool, but also failed to explain why some form of exemptive relief short of a blanket exemption from the entire Act would not be sufficient. As in *Chamber of Commerce*, a tailored exemption from specific requirements of the Advisers Act, consistent with the Commission's longstanding practice, "was neither frivolous nor out of bounds and the Commission therefore had an obligation to consider it." *Id*. at 145.

Public comments on the Broker Exemption repeatedly asked the Commission to consider a less sweeping approach to brokers who provide investment advisory services, but the Commission did not address these requests or the alternatives they suggested. For example, our letter dated February 7, 2005 stated:

> We agree that some areas of adviser and broker regulation may be duplicative, such as custodial requirements, but this is not a sufficient basis to exempt brokers from an entire regulatory regime. The Commission has broad exemptive authority under the Advisers Act to relieve brokers from duplicative requirements, and it could easily exercise

> that authority with respect to those requirements that are particularly burdensome.[4]

In addition, commenters specifically suggested modifications to particular Advisers Act requirements such as the testimonial and principal transactions rules, rather than granting a complete exemption from the Act,[5] but the Commission did not address these alternative approaches. The Commission violated the APA's requirement that it consider reasonable alternatives to the blanket Broker Exemption and explain the basis for rejecting them.[6]

[4] Letter from Fund Democracy, Consumer Federation of America, Consumers Union and Consumer Action to Jonathan Katz, Secretary, Securities and Exchange Commission at 12 (Feb. 7, 2005).

[5] *See* Letter from Duane Thompson, Group Director, Advocacy, Financial Planning Association to Jonathan Katz, Secretary, Securities and Exchange Commission at 7 (June 21, 2004) (suggesting alternative of applying testimonial rule to brokers, 17 C.F.R. § 275.206(4)-1(a)(1)); Letter from David Tittsworth, Executive Director, Investment Counsel Association of America to Jonathan Katz, Secretary, Securities and Exchange Commission at text accompanying nn. 28-29 (Jan. 12, 2000) (suggesting alternative of modifying principal transactions restrictions, 5 U.S.C. § 80b-6(3)).

[6] We note that the Broker Exemption is fundamentally different from the Commission's proposal to exempt thrifts from the definition of investment adviser. *See* 69 Fed. Reg. 25,778 (proposing to exempt thrifts that act as fiduciaries). That proposal is based on the understanding that thrifts have become the functional equivalent of banks, which Congress expressly excluded from the definition. *See* 15 U.S.C. § 80b-2(a)(11)(A). In contrast, Congress expressly excluded only brokers who did not receive special compensation or provide solely incidental advice.

B. The Broker Exemption is arbitrary and capricious because the Commission's interpretation of the "solely incidental" condition bears no rational relationship to the plain meaning of that term.

The Commission also violated the APA by failing to offer a rational explanation for the Broker Exemption. *See Motor Vehicles Mfrs. Assoc.*, 463 U.S. at 48 (reasoning that "an agency must cogently explain why it has exercised its discretion in a given manner"). The Commission based its adoption of the Broker Exemption on an understanding of the term "solely incidental" that bears no rational relationship to the plain meaning of that term.

The rationale underlying the Broker Exemption depends on the meaning of the term "solely incidental" in two ways. First, the Broker Exemption includes the condition that the advisory services provided by a broker who relies on the rule must be "solely incidental" to the brokerage services provided. *See* 17 C.F.R. § 275.202(a)(11)-1(a)(1)(i). Second, the Commission adopted the Broker Exemption on the basis of the continued vitality of the "solely incidental" prong of Section 2(a)(11)(C) of the Advisers Act (the only remaining prong after the Commission repealed Congress's "special compensation" prong). *See* 15 U.S.C. § 80b-2(a)(11)(C). The Commission interprets the term "solely incidental" for purposes of the Broker Exemption "consistently with the statutory provision." 70 Fed. Reg. 20,434. The Commission's interpretation of "solely incidental" bears no rational relationship to any reasonable understanding of that term and its reliance on this interpretation is arbitrary and capricious, thereby violating the requirements of the APA.

Under the Broker Exemption, the Commission interprets "solely incidental" as follows:

> In general, investment advice is "solely incidental to" the conduct of a broker-dealer's business within the meaning of section 202(a)(11)(C) and to "brokerage services" provided to accounts under the rule when the advisory services rendered are ***in connection with and reasonably related to*** the brokerage services provided.

70 Fed. Reg. 20,436 (emphasis added). The terms "in connection with" and "reasonably related to" are facially inconsistent with any reasonable interpretation of the term "solely incidental."

Webster's Dictionary defines "incidental," when used as an adjective, as "(1) being likely to ensue as a chance or minor consequence…, (2) occurring merely by chance or without intention or calculation," and when used as a plural noun as "minor items (as of expense) that are not particularized." Webster's Ninth New Collegiate Dictionary (1983); *see also* Black's Law Dictionary at 686 (5th ed. 1979). The SEC's understanding of the term includes advice far beyond the scope of its ordinary, common meaning. *See Perrin v. United States*, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning"); *Am. Fed'n of Gov't Employees, v. Glickman*, 215 F.3d 7, 10-11 (D.C. Cir. 2000) ("lack of a statutory definition does not render a term ambiguous, but, instead, it simply leads a court to give the term its ordinary, common meaning."). The Commission's "in connection with and reasonably related to" standard sets no limits on the degree of advisory services provided in relation to the brokerage services, much less in any way limit the advisory services to those that are "minor" or otherwise "incidental." Under the Commission's test, the advisory services may be the primary services, with brokerage services being "solely incidental" thereto, yet the advisory services still will not be regulated under the Advisers Act.

The Commission's interpretation also conflicts with Congress's use of the term "solely." "If possible," the court must "construe the statute so as to give effect to every clause and word." *Amoco Production Co. v. Watson*, 410 F.3d 722, 733 (D.C. Cir. 2005). The use of the modifier "solely" necessarily implies that the relevant category of "incidental" advisory services must be inherently distinct from some other category of advisory services, because there must be some advisory services that a broker could provide that would mean its advisory services were not "solely" incidental. *See* Webster's Ninth New Collegiate Dictionary (1983) (defining "solely" as: "without another" and "to the exclusion of all else"). Under the Commission's interpretation, the incidental advisory services do not represent a distinct category of advisory services. A broker's advisory services would always be "solely" incidental because ***all*** advisory services could be characterized as having been provided "in connection with and reasonably related to" the brokerage services provided.

The Commission's disregard of a reasonable interpretation of "solely incidental" is demonstrated in its statement: "Nor do we believe that Congress would have intended the Advisers Act to apply to all brokerage accounts receiving advice ***even when that advice is substantial***." 70 Fed. Reg. 20,434 (emphasis added). The position that Congress could have intended "solely incidental" advice to include "substantial" advice is a contradiction. The Commission argues that "Congress did not mandate that the nature ***or amount*** of the advice rendered by broker-dealers remain static in order for broker-dealers to avail themselves of the statutory exemption," *id*. (emphasis added)), but this position directly contradicts Congress's express intention that the advice rendered by

exempt brokers must remain static to the extent that they must remain "solely incidental."[7]

The Commission contradicts its own position by subjecting discretionary accounts managed by brokers to the Advisers Act. The Broker Exemption states that investment advice shall not be deemed to be "solely incidental" if the broker "[e]xercises investment discretion . . . over any customer accounts." 17 C.F.R. § 275.202(a)(11)-1(b). Advisory services provided in the form of discretionary account management, however, are no less likely to be provided "in connection with" or less likely to be "reasonably related to" brokerage services than non-discretionary advice. It is because the impermissibly broad "in connection with" and "reasonably related to" standard would otherwise consume even discretionary accounts that the Commission found it necessary to specifically remove them from the rule's purview.

Indeed, virtually all advisory services provided by brokers could reasonably be considered to be meet the "in connection with" and "reasonably related to" standard, as all of these brokers would, by definition, be providing some brokerage services to which the advice could be "connected." For the "solely incidental" test to make sense, some advisory services provided by brokers must trigger its application, but brokers will be able to deem all such services to have been provided "in connection with and reasonably related to" their brokerage services. The Commission's interpretation of the "solely incidental" test simply writes the "solely incidental" condition out of Section 2(a)(11)(C) and the Broker Exemption. The Commission's reliance in adopting the Broker Exemption on an unreasonable interpretation of "solely incidental" in both the Exemption

[7] Even the Commission's extremely strained interpretation of "solely incidental to" as referring to advisory services that follow "as a consequence" of a broker's brokerage business, 70 Fed. Reg. 20,436, cannot be reconciled with the Commission's "in connection with" and "reasonably related to" standard.

and the Advisers Act is arbitrary and capricious and thereby violates the APA, 5 U.S.C. § 706.

CONCLUSION

For the foregoing reasons, and the reasons stated in Petitioner's Brief, Fund Democracy and the Consumer Federation of America respectfully request that this Court grant the Petition, vacate the Broker Exemption, and remand to the Commission with instructions to act in accordance with the Court's opinion.

Dated: April 10, 2006

Respectfully Submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C) and Cir. R. 32(b), the undersigned attorney hereby certifies that this brief complies with the type-volume limitation in Fed. R. App. P. 32(a)(7)(B). The word processing system used to prepare this brief reflects that, excluding the portions of the brief Fed. R. App. P. 32(a)(7)(B)(iii) does not require counted, the brief contains 4,309 words.

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Thomas Henry Freeland, IV, Esq.

CERTIFICATE OF SERVICE

I hereby certify that on this 10th of April, 2006, copies of Brief of *Amici Curiae* in Support of Petitioner were mailed first-class, postage prepaid, to:

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