

## Enforcement Discretion at the SEC

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*The Dodd Frank Wall Street Reform Act allowed the Securities & Exchange Commission to bring almost any claim that it can file in federal court to its own Administrative Law Judges. The agency has since taken up this power against a panoply of alleged insider traders and other perpetrators of securities fraud. Many targets of SEC ALJ enforcement actions have sued on equal protection, due process, and separation of powers grounds, seeking to require the agency to sue them in court, if at all.*

*This article evaluates the SEC's new ALJ policy both qualitatively and quantitatively, offering an in-depth perspective on how formal adjudication—the term for the sort of adjudication over which ALJs preside—works today. It argues that the suits challenging the SEC's ALJ routing are without merit; agencies have almost absolute discretion as to who and how they prosecute, and administrative proceedings, which have a long history, do not threaten the Constitution. The controversy illuminates instead dueling traditions in the*

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*increasingly intertwined doctrines of corporate and administrative law; the corporate bar expects its judges to do equity, agencies, and their adjudicators, are more inclined to privilege procedural regularity.*

[Table of Contents will be reinserted]

“The SEC always seems to win before its in-house judges.”<sup>1</sup>

## Introduction

After a string of losses in federal court,<sup>2</sup> the Securities and Exchange Commission (SEC) decided to take some of its most important business elsewhere. In 2011, Rajat Gupta, the former chairman of the consulting firm McKinsey, was alleged to be part of a 28 defendant conspiracy to engage in insider trading.<sup>3</sup> Cases against 27 of the defendants were brought in federal court; his, one of the last to be brought, was diverted to an in-house Administrative Law Judge (ALJ).<sup>4</sup>

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1. John C. Coffee, Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models and What Can Be Done About It*, 101 YALE L.J. 1875, 1887 (1992).

2. [FA] <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> “the agency has also suffered some high-profile courtroom setbacks in the past year.”

3. SEC, Order Instituting Proceedings, In The Matter of Rajat K. Gupta, No. 3-14279, <https://www.sec.gov/news/press/2011/2011-53.htm> [<https://perma.cc/9ACQ-N4X3>].

4. Gupta was part of a conspiracy organized by principals of the Galleon Hedge Fund. As one judge put it, “On March 1, 2011, the Securities and Exchange Commission []—having previously

2016]

Zaring.A1Edit

103

Gupta was just the first high-profile defendant to get this treatment. In 2015, the SEC filed a complaint against Lynn Tilton, Wall Street’s “turnaround queen” and the owner of over 70 companies,<sup>5</sup> alleging that she had defrauded investors of \$200 million.<sup>6</sup> The agency asked one of its in-house SEC judges to decide the case.<sup>7</sup> Wing Chau, one of the antagonists of *The Big Short*, Michael Lewis’s best-selling book on the financial crisis, also found his case before an ALJ.<sup>8</sup> The Computer Sciences Corporation agreed

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filed all of its Galleon-related insider trading actions in this federal district—decided it preferred its home turf.” *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011).

5. Robert Frank, *Lynn Tilton Flaunts Her Style At Patriarch*, WALL ST. J. Jan. 8, 2011, at <http://www.wsj.com/articles/SB10001424052748704055204576068253540689070> [<https://perma.cc/QH4K-GPXE>].

6. SEC, Order Instituting Proceedings, *In The Matter of Lynn Tilton, et al.*, No. 3-16462, <https://www.sec.gov/litigation/admin/2015/ia-4053.pdf> [<https://perma.cc/DB8Z-L3JC>].

7. Tilton argued that this judge – in her view an employee of the SEC who reports to the very commissioners who decided to file suit against her – was “outside the chain of command of the United States.” Sheelah Kolhatkar, *How Lynn Tilton Went From Company Savior To SEC Target*, BLOOMBERG, July 16, 2015, <http://www.bloomberg.com/news/features/2015-07-16/how-lynn-tilton-went-from-company-savior-to-sec-target> [<https://perma.cc/5UTW-KVAV>]. Her lawyers argued that “The SEC’s administrative machinery does not provide a reasonable mechanism,” with the agency acting as both judge and prosecutor in Tilton’s case, to protect her rights. *Id.*

8. Richard F. Albert, *Duka v. SEC Redux - SEC Holds Home Court Advantage for Another Round*, FORBES, Apr. 23, 2105, <http://www.forbes.com/sites/insider/2015/04/23/duka-v-sec-redux-sec-holds-home-court-advantage-for-another-round/> [<https://perma.cc/44HH-KCDR>] (describing a “challenge to an SEC enforcement proceeding by Wing Chau, whose exploits were the subject of

to pay a \$190 million fine in a case that never saw the inside of a federal courtroom; the Commission settled that case as an administrative proceeding.<sup>9</sup>

These defendants have joined many others who, when they found out where their case was going to be heard, filed suit against the agency for unconstitutionally depriving them of their right to a day in court.<sup>10</sup> They have

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the best-selling book “The Big Short”).

9. Nicolas Goldin, *SEC Charges Computer Sciences Corporation & Former Executives With Accounting Fraud*, HARV. L. SCH. CORP. GOV. & FIN. REG. FORUM (July 23, 2015), <http://corpgov.law.harvard.edu/2015/07/23/sec-charges-computer-sciences-corporation-former-executives-with-accounting-fraud/> [<https://perma.cc/FX2N-TBTV>] (“the . . . SEC . . . entered into settled administrative cease-and-desist proceedings with Computer Sciences Corporation (“CSC”) and some of its former executives due to the company’s alleged manipulation of financial results and concealment of problems with the company’s largest contract”).

10. *See, e.g.*, Decision and Order, *Duka v. S.E.C.*, No. 15-357 (S.D.N.Y. Apr. 15, 2015) (considering equal protection “class of one” challenge); *Jarkesy v. S.E.C.*, 48 F. Supp. 3d 32, 35-36 (D.D.C. 2014) (considering due process and Administrative Procedure Act challenge); *Chau v. S.E.C.*, 2014 WL 6984236 at \*13-14 (S.D.N.Y. Dec. 11, 2014) (considering due process challenge); *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011) (considering due process and equal protection “class of one” challenge). Other challenges are still underway in the federal courts. *See, e.g.*, Complaint, *Tilton v. S.E.C.*, No. 15-2472 (S.D.N.Y. Apr. 1, 2015) (alleging separation of powers and appointments clause violations); Complaint, *Gray Financial Group v. S.E.C.*, No. 15-492, (N.D. Ga. Feb. 19, 2015) (alleging violation of appointments clause in double for-cause protection of SEC ALJs); Complaint, *Stilwell v. S.E.C.*, No. 14-7931 (S.D.N.Y. Oct. 1, 2014) (alleging due process violations and violation of appointments clause). The Computer Sciences

2016]

Zaring.A1Edit

105

argued that defendants cannot win before SEC ALJs, a complaint that has been echoed by columnists in the *New York Times*,<sup>11</sup> editorialists in the *Wall Street Journal*,<sup>12</sup> a white paper issued by the Chamber of Commerce,<sup>13</sup> and even, politely, by one of the SEC's own commissioners.<sup>14</sup> The agency's

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Corporation settled its case.

11. Gretchen Morgenson, *Crying Foul on Plans to Expand The SEC's In House System*, N.Y. TIMES, June 25, 2015, [http://www.nytimes.com/2015/06/28/business/secs-in-house-justice-raises-questions.html?\\_r=0](http://www.nytimes.com/2015/06/28/business/secs-in-house-justice-raises-questions.html?_r=0) [<https://perma.cc/8VKM-3QGH>] (“Is it right for defendants to be investigated, prosecuted and judged by officials of the same agency?”).

12. Russell G. Ryan, *The SEC As Prosecutor and Judge*, WALL ST. J., Aug. 4, 2014, <http://www.wsj.com/articles/russell-g-ryan-the-sec-as-prosecutor-and-judge-1407195362> [<https://perma.cc/P8HL-UGL4>] (“a surge in administrative prosecutions should alarm anyone who values jury trials, due process and the constitutional separation of powers”).

13. U.S. Chamber of Commerce, *Enhancing American Competitiveness* 14 (2015), <https://securitiesdiary.files.wordpress.com/2014/11/chamber-of-commerce-report-on-reforms-needed-in-sec-enforcement-process.pdf> [<https://perma.cc/XT4X-8C8M>] (“[t]hroughout its modern history, there has been criticism of the Commission’s use of administrative proceedings to create regulatory policy”). Along the same lines, an American Bar Association task force studied 62 SEC administrative cases over a five-year period and found that administrative law judges upheld the SEC in 58 of the cases. *See ABA Task Force Survey Finds ALJs Almost Always Uphold SEC Charges*, 21 Sec. Reg. & L. Rep. (BNA) No. 40, at 1531 (Oct. 13, 1989). *See also* Coffee, *supra* note 1, at 1893 (making a similar claim about SEC ALJs at the very beginning of their roles in enforcement proceedings).

14. Michael Piwowar, SEC Commissioner, *A Fair, Orderly, and Efficient SEC*, Feb. 20, 2015, [http://www.sec.gov/news/speech/022015-spchcmsp.html#\\_ftnref3](http://www.sec.gov/news/speech/022015-spchcmsp.html#_ftnref3) [<https://perma.cc/UG97-8J9W>] (addressing the need to “avoid the perception that the Commission is taking its tougher cases to its

inspector general has conducted an investigation into whether the ALJs are biased.<sup>15</sup> One federal judge has said that these arguments are “compelling and meritorious.”<sup>16</sup> Other judges have agreed.<sup>17</sup>

The SEC has vigorously—and, this Article argues, correctly—defended its power to choose where it sues. Agencies have always enjoyed unfettered discretion to choose their enforcement targets and their policymaking fora.<sup>18</sup> Formal adjudication under the Administrative Procedure Act (APA), which is the process SEC ALJs offer, has been with us for decades, and has never before been thought to be unconstitutional in any way.<sup>19</sup> It violates no rights,

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in-house judges” and to “ensure that all are treated fairly and equally”).

15. However, the SEC’s inspector general did not “develop any evidence to support allegations of bias by ALJs in Commission proceedings.” Memo from Inspector General Carl Hoeckler to SEC Chair Mary Jo White, *Transmittal of Report of Investigation: 15-ALJ-0482-I*, 3 (Aug. 8, 2015), <https://www.sec.gov/oig/reportspubs/oig-sec-interim-report-investigation-admin-law-judges.pdf> [<https://perma.cc/GY4G-V4K3>].

16. *Bebo v. S.E.C.*, No. 15-C-3, 2015 WL 905349, at \*2 (E.D. Wis. Mar. 3, 2015).

17. *See, e.g., Hill v. S.E.C.*, No. 1:15-CV-1801-LMM, 2015 WL 4307088, at \*6 (N.D. Ga. June 8, 2015); Bob Van Voris, *SEC Loses Again as U.S. Judge Rejects In-House Court Process*, BLOOMBERG, Aug. 12, 2015, <http://www.bloomberg.com/news/articles/2015-08-12/u-s-judge-blocks-sec-case-against-ex-s-p-executive-duka> [<https://perma.cc/GG6B-BRNC>].

18. **[FA]Chenery v. SEC (providing agencies with the unreviewable discretion to choose between rulemaking and adjudication), Heckler v. Chaney (making enforcement decisions by agencies unreviewable)**

19. As Michael Asimow has said, “the big story of the APA is that it transformed the

2016]

Zaring.A1Edit

107

nor offends the separation of powers; if anything scholars have bemoaned the fact that it offers inefficiently large amounts of process to defendants, administered by insulated civil servants who in no way threaten the president's control over the executive branch.<sup>20</sup>

The most interesting questions posed by the SEC's new policy are not doctrinal; they are empirical and cultural.<sup>21</sup> An agency's turn to formal adjudication is a rare thing these days;<sup>22</sup> it warrants an investigation of how this grand, old, but increasingly disregarded, institution works in its

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disrespected crew of agency hearing examiners into the highly respected and highly protected corps of ALJs we know today." Michael Asimow, *The Administrative Judiciary: ALJs in Historical Perspective*, 20 J. NAT'L ASS'N ADMIN. L. JUDGES 157, 163 (2000).

20. See, e.g., Richard J. Pierce, Jr., *Political Control Versus Impermissible Bias in Agency Decisionmaking: Lessons from Chevron and Mistretta*, 57 U. CHI. L. REV. 481, 507 (1990) (suggesting that courts protect ALJ independence at a cost of efficiency, and that they should permit agencies to "discipline inefficient ALJs"); JERRY L. MASHAW, BUREAUCRATIC JUSTICE: MANAGING SOCIAL SECURITY DISABILITY CLAIMS 117 (1983) (praising efforts to streamline evidentiary problems with disability claims, "from the perspective of an administration concerned with systemic rationality").

21. Though the doctrinal analysis is certainly interesting in its own right; the argument in this article is only that it is straightforward.

22. **[The current decline in agency use of administrative law judges to conduct formal adjudications**

**Jeffrey S. Lubbers, *Apa-Adjudication: Is the Quest for Uniformity Faltering?*, 10 Admin. L.J. Am. U. 65, 79 (1996)]**

reinvigorated form at the SEC, both qualitatively and quantitatively. This Article shows that defendants can rarely escape liability before ALJs, but can reduce their damages, relative to the amount sought by the agency's Enforcement Division. It also documents the routine nature of much of what ALJs do; defaulting defendants who fail to respond to complaints, imposing sanctions on brokers and investment advisers who have already been adjudged to commit securities fraud in federal court, and so on. Adding high profile insider trading and other cases of first impression to this mix is different from the ordinary sort of work that ALJs are expected to do.

But as a legal matter, there is little doubt that ALJs enjoy the power to do that work. So why so much drama? The increasingly vocal campaign against SEC enforcement proceedings is animated by a worthy debate what adjudication is supposed to be about.

That debate concerns a commitment to equity. Corporate lawyers have traditionally looked to equitable principles—especially fiduciary obligations of loyalty and care—to solve the principal-agent problems posed by the separation of ownership and control in the modern corporation. Courts in the state of Delaware apply these equitable principles as standards (and not rules) concerned with responsibility and fairness.<sup>23</sup> Federal criminal and securities

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23. “Delaware corporate law may well be seen as an extended commentary on the concepts of legality and equity. . . . in Delaware, equity trumps.” DELAWARE SUPREME COURT: GOLDEN ANNIVERSARY 1951-2001, 92 (RANDY J. HOLLAND & HELEN L. WINSLOW EDS., 2001); For a very



2016]

Zaring.A1Edit

109

cases, which interpret hazy common law terms like “fraud” and “intent” also feature, at least traditionally, a number of judges, often located in Manhattan, who subject the government to principles-based standards of propriety.<sup>24</sup>

But federal agencies, and the ALJs who work for them, unlike the Delaware or federal courts, make their decisions about policy constrained by procedure, rather than fairness.<sup>25</sup> ALJs who made sweeping equitable rulings against their agencies would likely be quickly reversed on appeal to the

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well-known discussion, see Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997) (“Delaware courts generate in the first instance the legal standards of conduct (which influence the development of the social norms of directors, officers, and lawyers) largely through what can best be thought of as “corporate law sermons.” These richly detailed and judgmental factual recitations, combined with explicitly judgmental conclusions, sometimes impose legal sanctions but surprisingly often do not.”); *see also* William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792-1992*, 18 DEL. J. CORP. L. 819, 821-22 (1993) (“Equity is the flexible application of broad moral principles (maxims) to fact specific situations for the sake of justice. Delaware has preserved the essence.”).

24. *See, e.g.*, Gerard E. Lynch, *The Role of Criminal Law in Policing Corporate Misconduct*, 60 LAW & CONTEMP. PROBS. 23, 54 (Summer 1997) (“The EPA or SEC lawyer may be better able to compare each case with other violations of securities or environmental laws, in terms of its importance to operating honest capital markets or protecting environmental quality, but the prosecutor is better equipped to compare the violation with other types of crime in terms of the moral blameworthiness of conduct, the degree of departure from general standards of citizenship, and the equity of imposing stigmatizing punishment.”).

25. [FA]

commissioners for whom they work.<sup>26</sup> They are generally uninterested in the fuzzy equitable mores of the chancery and more focused on the requirements of the APA, as interpreted by the D.C. Circuit and the Supreme Court. This procedure-based orientation is importantly different from the equity-based hopes that the corporate bar place in the judges who would hear their cases.<sup>27</sup>

It is, moreover, worth getting to the bottom of the difference. How administrative adjudicators are supposed to approach their work is, or at least was, one of the central questions of administrative law. The American administrative state was founded on adjudication by agency officials. The first federal agencies were little more than specialized courts; the Interstate Commerce Commission, founded in 1887, scrutinized the rates set by railroads to see whether they were “unjust and unreasonable” on a case by case basis.<sup>28</sup> The Federal Trade Commission, founded in 1914, broke up

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26. There are good reasons for this, too. *See infra* Part III.

27. Daniel Richman, *Political Control of Federal Prosecutions: Looking Back and Looking Forward*, 58 DUKE L.J. 2087, 2118 (2009) (“[a]long these lines, see a substantial disjunction between regulatory agencies and criminal prosecutors sends inefficiently noisy signals about government policy to regulatory subjects and creates confusing, sometimes even bad, law”).

28. In 1917, Adolph Berle described the ICC’s work as, essentially, judicial. A. A. Berle, Jr., *The Expansion of American Administrative Law*, 30 HARV. L. REV. 430, 442 (1917) (“it was said that the functions it exercised were “quasi-judicial”; and the present method of stating the result is that the [ICC] has full authority to inquire into judicial matters”).

2016]

Zaring.A1Edit

111

trusts, similarly, on a trust by trust basis.<sup>29</sup> These agencies were expected to make most of their policy decisions through hearings at which counsel would appear on behalf of both the agency and regulated industry and evidence would be presented in a trial-type atmosphere.<sup>30</sup>

But the adjudicative model has fallen into disfavor. Modern agencies such as the Environmental Protection Agency do almost all of their important work through lengthy and complicated rulemakings.<sup>31</sup> The federal government now employs 1,760 Administrative Law Judges, but the vast majority of those judges work for the Social Security Administration hearing appeals of revocations of determinations of disability.<sup>32</sup> The D.C. Circuit in 1970 waxed rhapsodic about the FTC's decision to abandon its trial model of policymaking it issued its octane labelling rule, observing that "courts are recognizing that use of rule-making to make innovations in agency policy may actually be fairer to regulated parties than total reliance on case-by-case

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29. Lesley Fair, *FTC Milestones: Shared Beginnings In The Circle Cilk Case*, FTC COMPETITION MATTERS, <https://www.ftc.gov/news-events/blogs/competition-matters/2014/11/ftc-milestones-shared-beginnings-circle-cilk-case> [<https://perma.cc/L8EQ-X5HK>] (Nov. 10, 2104) ("The FTC's founding is often associated with turn-of-the-century trust busting").

30. [FA]

31. [FA]

32. For an approximate, if dated, distribution and analysis in by a legal scholar, see Bernard Schwartz, *Adjudication and the Administrative Procedure Act*, 32 TULSA L.J. 203, 213 (1996) (reviewing the agency assignments of the then 1332 ALJs accredited by the federal government).

adjudication.”<sup>33</sup>

If the SEC is planning to return to administrative adjudication as a substitute to enforcement through the courts, and an important instrument for setting policy, then it will be reinvigorating formal adjudications, at least in one agency. To be sure, the data suggest that the picture is at least somewhat murky, as the agency has not stopped filing federal lawsuits, and ALJ work is increasing, but not exponentially.<sup>34</sup> But if ALJs continue to perform as administrative proceduralists, rather than doers of equity, then the corporate bar will have to get used to a different sort of approach from the tribunals before which they appear. As they grow used to the constraints and methods of ALJs, they may grow to appreciate the consistency offered by administrative law.

Part I of what follows describes how administrative adjudication works at the SEC, using both qualitative and quantitative measures; it presents a picture of the way ALJ adjudication works today. Part II, the doctrinal portion of the article, reviews and dismisses the doctrinal claims made against the constitutionality of the SEC’s new policy preferring administrative adjudication. Part III considers the principal basis for concern about the SEC’s new policy, which is that it places defendants in the hands of judges

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33. Nat’l Petroleum Refiners Ass’n v. FTC, 482 F.2d 672, 681 (D.C. Cir. 1973).

34. See *infra* Part I.D.

2016]

Zaring.A1Edit

113

unlikely to do equity in the way that Article III judges might. A brief conclusion follows.

#### I. Administrative Proceedings Today: The SEC's ALJs

The controversy about the SEC's decision to route more cases towards ALJs is based on a dispute about whether administrative proceedings offer a similar sort of justice to that offered by duly confirmed federal judges.

To understand why we might trust administrative adjudicators to handle justiciable matters, it is necessary to take a tour through what those adjudicators do. In this section, the way that administrative proceedings work is reviewed, and a dataset of all of the decisions issued by those adjudicators since the enactment of Dodd-Frank is analyzed, both qualitatively and quantitatively. As we will see, the critics are correct that the agency wins frequently in administrative proceedings, but the outlook for defendants who get to the point of seeking an opinion from an adjudicator is not unremittingly bleak. The ensuing picture of how administrative adjudication works today will be illuminating for both corporate lawyers and those interested in the state of formal procedures in administrative law today.

In Part II of the article, we will see that courts, generally do permit agencies to do the sorts of things that judges do; to understand why, the relatively thick account that follows provides the factual underpinnings for those legal conclusions.

A. *ALJ Jurisdiction*

The SEC cannot bring criminal charges against defendants in house,<sup>35</sup> but when it concludes that the securities laws have been broken, it now has an essentially unfettered choice between taking its civil complaint to an Article III or agency judge.<sup>36</sup> The agency route, moreover, offers most of the remedies that civil litigation offers the SEC. ALJs can censure, suspend, bar or fine defendants, either by ordering the disgorgement of sums earned while the securities laws were being breached or through the imposition of civil monetary penalties.<sup>37</sup>

This history of administrative proceedings reaches back to the founding of the agency, but the modern era – the era where administrative proceedings took off – began in 1990; Dodd-Frank sharply expanded the jurisdiction of ALJs again in 2010.<sup>38</sup>

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35. Indeed, the SEC does not have the power to bring criminal cases for breaches of the securities laws, although its staff often launch investigations of these sorts of efforts. *See SEC, How Investigations Work*, <http://www.sec.gov/News/Article/Detail/Article/1356125787012> [<https://perma.cc/APL5-J6DQ>] (2012) (“the [SEC’s Enforcement] Division works closely with law enforcement agencies in the U.S. and around the world to bring criminal cases when appropriate”).

36. Though it is under some constraints. *See infra* Part I.C.

37. [FA]

38. As Bob Van Vorts and Matt Robinson put it, “The regulator began holding administrative hearings shortly after its creation in 1934. The Dodd-Frank law, enacted in 2010, expanded the agency’s jurisdiction beyond brokers and investment advisers and empowered its judges to issue

2016]

Zaring.A1Edit

115

The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 imposed the ALJ enforcement regime upon those registered with the SEC, including broker-dealers, investment advisers, and firms that registered securities with the agency.<sup>39</sup>

The statute created the modern regime of administrative proceedings by giving the Enforcement Division the right to bring cases against these regulated defendants administratively, rather than in federal court. These jurisdictional rights were awarded by increasing the remedies available through these proceedings. ALJs were given the power to order disgorgement of ill-gotten gains against defendants, and issue fines, but much of the threat of administrative proceedings laid in the injunctive powers enjoyed by the judges. The Penny Stock Reform Act awarded the ALJs cease-and-desist powers—that, is, powers prohibiting licensed firms and persons from violating the securities laws, and the ability to bar, or revoke the license of, defendants from doing securities industry work.<sup>40</sup>

The threat to the livelihood of practitioners made agency adjudicators

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orders and levy fines that previously had been available only in federal court.” Bob Van Vorts & Matt Robinson, *For The SEC, A Question of Justice for All*, BLOOMBERG BUSINESS, Aug. 10, 2015, <http://www.bloomberg.com/news/articles/2015-08-10/for-the-sec-s-in-house-court-a-question-of-justice-for-all> [<https://perma.cc/3EBJ-JYM8>].

39. Pub. L. No. 101-429 (Oct. 15, 1990).

40. Pub. L. No. 101-429 (Oct. 15, 1990), § 203 (codified at 15 U.S.C. § 77h-1).

important to a new class of potential defendants, but it left the federal courts with exclusive jurisdiction over cases where the securities laws were violated, but the defendants were not licensed to practice before the commission.<sup>41</sup> These included most insider trading claims, securities fraud claims, claims about unregistered securities – the sorts of cases most likely to generate headlines.<sup>42</sup>

Dodd Frank expanded the agency’s jurisdiction to any entity within the agency’s jurisdiction, rather than only registered with the agency, essentially by permitting the agency to pursue any remedy against unregistered defendants that it could pursue against registered defendants.<sup>43</sup>

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41. [FA]

42. [FA]

43. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (Jul. 21, 2010), § 929p (codified at 15 U.S.C. § 78u-3). The statute broadened the SEC’s authority to impose industrywide suspensions, which prohibit securities professionals who are found to have violated any aspect of securities laws from joining any regulated entity, including brokers, dealers, investment advisors, participants in the municipal securities markets, transfer agents, and rating agencies. *Id.* As Andrew Ceresney, the director of the Enforcement Division explained, “Congress provided us authority to obtain penalties in administrative proceedings against unregistered parties comparable to those we already could obtain from registered persons.” Andrew Ceresney, *Remarks to the American Bar Association’s Business Law Section Fall Meeting*, [http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#\\_ftnref9](http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#_ftnref9) [https://perma.cc/RF52-6ZLA] (Nov. 21, 2014).



2016]

Zaring.A1Edit

117

*B. Process*

In ALJ proceedings, the SEC's Enforcement Division brings the case against the defendant, the judge is an employee of the SEC, and appeals from the proceeding go to SEC commissioners, making the SEC plaintiff, judge, and reviewer. All of this is permitted by the agency's Rules of Practice.<sup>44</sup>

But while *nemo iudex in sua causa*—no man should be judge in his own case—is one of the most traditional, or at least Latinate, of the propositions of Anglo-American law, agencies have always conducted a variety of adjudications; when ALJs are involved, these proceedings look adversarial and lawyerly.<sup>45</sup> The SEC's rules, for example, provide for a trial experience that is analogous to that that would occur before a federal judge.<sup>46</sup>

The authority of ALJs to exercise broad discretion within the scope of their statutory authorization has been established by the Supreme Court.<sup>47</sup>

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44. See 17 C.F.R. § 201, *et seq.*

45. Adrian Vermuele, Essay: *Contra Nemo Iudex in Sua Causa: The Limits of Impartiality*, 122 YALE L.J. 384, 386 (2012) (discussing some of the intricacies of the proposition in the context of administrative adjudication).

46. [FA]

47. See, e.g., *Federal Maritime Comm'n v. South Carolina Ports Authority*, 535 U.S. 743, 759 (2002) (“[T]he role of the ALJ . . . is similar to that of an Article III judge.”); *Butz v. Economou*, 438 U.S. 478, 513 (1978) (“[T]he role of the modern . . . administrative law judge . . . is ‘functionally comparable’ to that of a judge.”). See also Ken Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 798 (2013) (“Federal administrative law judges . . . are the demigods of

ALJs oversee adversarial proceedings, rule on evidentiary questions, regulate the course of the hearing, and make decisions.<sup>48</sup> They have the authority to administer oaths and affirmations to witnesses and oversee the questioning of witnesses, ruling on questions of admissibility and taking offers of proof.<sup>49</sup> ALJs also have the full subpoena power of the agency itself and may issue subpoenas to third parties within the scope of the SEC's statute.<sup>50</sup>

ALJs cannot hear counterclaims against the SEC, but they are free to consider a wide range of constitutional and common law issues and defenses, at least in the first instance.<sup>51</sup>

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federal adjudication.”).

48. *Butz*, 438 U.S. at 513. The scope of SEC ALJs authority is equal to that of all other ALJs under the APA. *See* SEC Rules of Practice, Rule 111, 17 C.F.R. § 201.111 (“No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the Administrative Procedure Act, 5 U.S.C. 556, 557.”).

49. 17 C.F.R. § 201.111(a), (c).

50. 17 C.F.R. § 201.111(b).

51. *See* *McKart v. U.S.*, 395 U.S. 185, 193-94 (1969) (“[N]otions of administrative autonomy require that the agency be given a chance to discover and correct its own errors”). *See also* *Chau v. S.E.C.*, 2014 WL 6984236, at \*13 (S.D.N.Y. Dec. 11, 2014) (noting that SEC ALJs have authority to consider constitutional challenges to the fairness of the administrative hearing itself, “at least in the first instance”). SEC ALJs have issued initial decisions addressing a wide range of constitutional issues and common law defenses raised by respondents. *See, e.g.*, *In re Harding Advisory LLC*, SEC Decision No. 734 (Jan. 12, 2015) (considering equal protection and due process issues); *In re Michael A. Horowitz*, SEC Decision No. 733 (Jan. 7, 2015) (considering respondent’s defenses of

2016]

Zaring.A1Edit

119

The ALJ serves as the finder of fact and of law; there is no jury. The Federal Rules of Civil Procedure and the Federal Rules of Evidence do not apply; instead the proceedings are governed by the SEC's own Rules of Procedure.<sup>52</sup> These rules differ from the court rules; for example, any evidence that "can conceivably throw any light upon the controversy," including hearsay, "normally" is admissible.<sup>53</sup> Depositions are rare—although this differs little from federal cases involving enforcement developed by agency employees, let alone criminal prosecutions.<sup>54</sup> Some motions, including motions to dismiss, are unavailable.<sup>55</sup>

The agency's statute and Rules of Practice provide for a so-called

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laches and equitable estoppel); In re John Thomas Capital Management Group LLC, SEC Decision No. 693 (Oct. 17, 2014) (considering impartiality of SEC tribunal and ex parte communication between prosecutor and ALJ).

52. 17 C.F.R. § 201 *et seq.*

53. In the matter of J. Allen Ochanpaugh, Exchange Act Release No. 54363, 2006 SEC Lexis 1926, \*23 n.29 (Aug. 25, 2006).

54. SEC Rules of Practice, Rule 233, 234, 17 C.F.R. § 233, 234. As the SEC's director of enforcement has said, however, "The Federal Rules of Criminal Procedure allow for depositions only in "exceptional circumstances," which is similar to what the Commission's Rules of Practice allow." *Andrew Ceresney, Remarks to the ABA Business Law Section*, Nov. 21, 2014, <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#.VR2scPmjNcY> [<https://perma.cc/JQ7E-W8V9>].

55. In the Matter of Jeffrey L. Feldman, Admin. Proc. File No. 3–8063, 1994 WL 23256, at \*2, 1994 SEC LEXIS 186, at \*4–5 (Jan. 14, 1994).

“rocket docket.” An initial hearing must take place not more than 60 days after the notice instituting proceedings, unless the respondent consents to an extension.<sup>56</sup> The ALJ must issue an initial decision within at most 300 days of the date of the order instituting proceedings, although the agency can seek a single month-long extension; meaning that most cases are on a track to be resolved within either four months—the typical time frame—or one year.<sup>57</sup> In federal court, of course, few litigated proceedings are concluded in such a brief period.<sup>58</sup>

Otherwise, SEC ALJs otherwise enjoy many of the powers that trial judges have. They can take testimony, hold hearings, conduct trials, rule on the admissibility of evidence, and may issue subpoenas as well as rule on motions and protective orders.<sup>59</sup>

Appeals from the ALJ’s “initial decision” are made to SEC itself, which can amend or reverse the decision, although it usually does not.<sup>60</sup> In this way,

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56. 15 U.S.C. § 78u-3(b). The rocket docket was implemented by rule in 2003. For a discussion, see AM. BAR. ASS’N, *THE SECURITIES ENFORCEMENT MANUAL* 327-28 (MICHAEL MISSAL & RICHARD M. PHILLIPS, EDS.) (2D ED. 2007)

57. SEC Rules of Practice, Rule 360, 17 C.F.R. § 201.360.

58. [FA]

59. 5 U.S.C. § 556-57 (setting forth the procedures for formal adjudications presided over by an ALJ).

60. See, e.g., SEC, ALJ Initial Decision, *In the Matter of Gaeton S. Della Penna*, Initial Decision Release No. ID-757, File No. 3-16198 (2015) (The agency’s ALJs have standard language

2016]

Zaring.A1Edit

121

the SEC is the body that issued the administrative complaint in the first place, making it a peculiar combination of judge – ALJs work for the SEC – prosecutor – the agency’s Enforcement Division brings the actions before the adjudicators – and appellate court.

If dissatisfied with the decision of the agency (or non-decision, if the agency silently adopts the decision of the ALJ), petitioners can then appeal to a federal appeals court.<sup>61</sup> There, their claims will be evaluated under the deferential standards of review provided by administrative law.<sup>62</sup> In particular, the ALJs factual findings, if accepted by the agency, will be

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for this in their orders. *See, e.g.*, The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party.”).

61. 5 U.S.C. § 706.

62. Though it is not clear that the deferential nature of the standards makes much of a difference. David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135, 140 (2010) (“I infer a developing consensus that the various standards, in the end, look to reasonableness as the baseline for evaluating agency action.”). Nonetheless, Judge Jed Rakoff of the SDNY has observed that “while the decisions of federal district courts on matters of law are subject to de novo review by the appellate courts, the law as determined by an administrative law judge in a formal administrative decision must be given deference by federal courts unless the decision is not within the range of reasonable interpretations.” Jed S. Rakoff, *Is the SEC Becoming a Law Unto Itself?*” Address, PLI Securities Regulation Institute, Nov. 5, 2014.

reviewed under the “substantial evidence” standard.<sup>63</sup> By contrast, in federal trial court, the agency must establish facts through a preponderance of the evidence standard.<sup>64</sup> All courts, whether administrative or Article IIIs generally apply the doctrines of collateral estoppel and res judicata to final determinations by agency judges, which can affect decisions whether to settle in cases where claims are being brought against defendants in other fora, by, say, state attorneys general or private plaintiffs.<sup>65</sup>

ALJs receive career appointments; their terms are not time-limited.<sup>66</sup> They may be only removed from their position for good cause, which must be “established and determined” by the Merit Systems Protection Board

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63. *See* NLRB v. Universal Camera Corp., 340 U.S. 474, 478-79 (1951) (discussing what the substantial evidence test requires at length).

64. It is not entirely clear that the first contact with a federal court is the right comparison, however. On appeal, the federal court’s factual findings would be reviewed for an abuse of discretion, or, if a jury was involved, be reviewed at least as deferentially as would be an appeal from an agency factfinding, even one done on a substantial evidence standard. Fed. R. Civ. P. 52(a)(6) (“Findings of fact, whether based on oral or other evidence, must not be set aside unless clearly erroneous, and the reviewing court must give due regard to the trial court’s opportunity to judge the witnesses’ credibility.”).

65. *See* Astoria Federal Sav. & Loan Ass’n v. Solimino, 501 U.S. 104, 107 (1991); AM. BAR. ASS’N, THE SECURITIES ENFORCEMENT MANUAL 338 (MICHAEL MISSAL & RICHARD M. PHILLIPS, EDS.) (2D ED. 2007).

66. 5 C.F.R. § 930.204(a).

2016]

Zaring.A1Edit

123

(MSPB).<sup>67</sup> The SEC commissioners are the officers who would remove the administrative judges and they themselves are only removable for “inefficiency, neglect of duty or malfeasance in office.”<sup>68</sup> Members of the MSPB who hear the case against SEC ALJs are also only removable for the same reasons.<sup>69</sup>

All of these doctrines make the ALJs insulated and the process before them different from that in district court. But administrative defendants enjoy one advantage over those charged in district court. The SEC’s rule of practice impose *Brady* obligations on the agency—a requirement that it turn over all exculpatory information to the defendant before any hearing—which only applies to criminal defendants in federal court, and not to civil defendants in other contexts.<sup>70</sup>

The availability of *Brady* discovery has not persuaded practitioners that they benefit from being hauled before an ALJ. Lawyers often worry about administrative proceedings. “If given a choice . . . most practitioners would

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67. 5 U.S.C. § 7521(a).

68. *MFS Securities Corporation v. SEC*, 380 F. 3d 611, 619-20 (2d Cir. 2004).

69. 5 U.S.C. § 1202(d).

70. SEC Rules of Practice, Rule 230(a)(1) (“the Division of Enforcement shall make available for inspection and copying by any party documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division’s recommendation to institute proceedings,” citing *Brady v. Maryland*, 373 U.S. 83, 87 (1963)).

choose” district court “because of the availability of powerful discovery tools under the Federal Rules of Civil Procedure and a whole independent adjudicator,” opine the authors of one treatise.<sup>71</sup> William McLucas, a former enforcement head at the agency and perhaps the leader of the defense bar has also expressed concern:

With limited ability to obtain documents needed for a defense, with no opportunity to depose witnesses like the SEC did during the often multiyear investigation leading to the charges, and with insufficient time to locate defense expert witnesses to respond to the SEC’s experts, these proceedings can be stacked in favor of the SEC.<sup>72</sup>

These criticisms have increased since the SEC has brought more proceedings, and more high profile proceedings, before ALJs.<sup>73</sup>

### C. Remedies

ALJs cannot punish precisely in the way a district court judge can. Only a federal judge may issue an order pursuant to Section 21(d)(2) of the Securities Exchange Act prohibiting a person from serving as an officer or

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71. AM. BAR. ASS’N, *THE SECURITIES ENFORCEMENT MANUAL* 327 (MICHAEL MISSAL & RICHARD M. PHILLIPS, EDS.) (2D ED. 2007).

72. He did so in an editorial co-written with the agency’s chief litigation counsel. William McLucas and Matthew Martens, *How to Reign In The SEC*, WALL ST. J., June 2, 2015, <http://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747> [<https://perma.cc/85NS-CEK3>].

73. [FA]



2016]

Zaring.A1Edit

125

director of a public company.<sup>74</sup> Only a judge can require forfeiture of incentive-based or stock-based compensation following a restatement of financial statements under Section 304 of Sarbanes-Oxley.<sup>75</sup> And, of course, only a judge can hear criminal cases for violations of the securities laws.<sup>76</sup>

But ALJs hold real powers over defendants, given the sanctions that they may impose.<sup>77</sup> The cease and desist, let alone the disbarment, power matters because it can be used for future injunctions of indeterminate length. Refusing to permit a person the right to practice before the SEC mean, for brokers, accountants, and others, that their careers are over.

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74. 15 U.S.C. § 78u(d)(2) (“the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person . . . from acting as an officer or director of any issuer that has a class of securities registered”).

75. Sarbanes-Oxley Act of 2002 § 304(a), 15 U.S.C. § 7243(a). For a discussion of this so-called clawback power by an SEC official, see Rachael E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 BUS. LAW. 1, 35 (2008).

76. The SEC does not have the power to prosecute criminal matters, for that matter; it instead investigates the crimes, and reliefs upon the Department of Justice to bring the case. *See* 17 C.F.R. § 202.5(f) (memorializing this relationship as a matter of SEC policy). For a discussion, see Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 645 (2010) (“Although the SEC makes independent decisions to bring civil enforcement actions, the Department of Justice and the relevant U.S. Attorney’s offices filter criminal referrals.”).

77. [FA]

Moreover, ALJs can impose substantial damages and fines. The SEC's ability to enter civil monetary penalties was, until the passage of Dodd-Frank, limited to regulated persons.<sup>78</sup> Monetary penalties remain relatively small, up to \$160,000 for individuals and \$775,000 for corporations for each violation of the laws (the maximum number is adjusted for inflation).<sup>79</sup> In addition to the civil penalties, the statute provided that in any proceeding in which the SEC could impose a penalty, the commission could also "enter an order requiring accounting and disgorgement."<sup>80</sup>

Disgorgement can be punishingly large.<sup>81</sup> The agency defines disgorgement as "the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible."<sup>82</sup> But disgorgement

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78. Pub. L. No. 101-429 (Oct. 15, 1990), § 202 (codified at 15 U.S.C. § 78u-2).

79. Pub. L. No. 101-429 (Oct. 15, 1990), § 202(b) (codified at 15 U.S.C. § 78u-2(b)). The latest table of potential fines, reflecting the inflation rate may be found at <http://www.gpo.gov/fdsys/pkg/CFR-2013-title17-vol2/pdf/CFR-2013-title17-vol2-part201-subpartE-appV.pdf> [<https://perma.cc/MV8P-KAND>].

80. Pub. L. No. 101-429 (Oct. 15, 1990), § 202(e) (codified at 15 U.S.C. § 78u-2(e)).

81. While the 1990 statute explicitly gave the SEC the power to seek disgorgement in the federal forum, the SEC has long sought disgorgement as an equitable remedy in enforcement actions in federal court. *See, e.g.,* Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 2, n. 12 (2013).

82. SEC 2014 AGENCY FINANCIAL REPORT 66 (2014), available at <http://www.sec.gov/about/secafr2014.shtml> [<https://perma.cc/NVQ7-PHKP>].

2016]

Zaring.A1Edit

127

is intended to deprive a wrongdoer of ill-gotten gains.<sup>83</sup> The agency views disgorgement as not primarily designed to compensate victims, but instead as a critical deterrent to violations of the securities laws.<sup>84</sup> As a consequence, disgorgement avoids some of the almost philosophical difficulties posed by questions of investor harms assuming diversified holdings and efficient markets, and gives the agency a variety of avenues that can be used to establish a high damages calculation.

To this end, SEC need only show that the amount sought is a “reasonable approximation of profits causally connected to the violation.”<sup>85</sup> An order for disgorgement creates a personal liability for the defendant, just as a civil penalty would, and the defendant must pay the disgorgement amount regardless of whether he or she retained the proceeds of the violation.<sup>86</sup>

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83. S.E.C. v. Teo, 746 F.3d 90, 105 (3d Cir. 2014) (citing S.E.C. v. Whittemore, 659 F.3d 1, 10-11 (D.C. Cir. 2011)). *See also* S.E.C. v. Contorinis, 743 F.3d 296, 301 (2d Cir. 2014) (“Disgorgement is an equitable remedy, imposed to force a defendant to give up the amount by which he was unjustly enriched.” (internal quotations omitted)).

84. S.E.C. v. Cavanagh, 445 F.3d 105, 117 (2d Cir. 2006) (“In a securities enforcement action, as in other contexts, disgorgement is not available primarily to compensate victims. Instead, disgorgement has been used by the SEC and courts to prevent wrongdoers from unjustly enriching themselves through violations, which has the effect of deterring subsequent fraud.”).

85. S.E.C. v. First City Financial Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989).

86. S.E.C. v. Whittemore, 659 F.3d 1, 9-10 (D.C. Cir. 2011) (“A disgorgement order pertains to a sum equal to the amount wrongfully obtained, rather than a requirement to replevy a specific asset, and establishes a personal liability, which the defendant must satisfy regardless of whether he

Moreover, the remedy reaches more than ill-gotten gains made through illegal trades. The SEC deems disgorgement to include salary earned during violation of the securities laws.<sup>87</sup> And, as Urska Velikonja has reminded us, it can even include the disgorgement of a benefit received by someone else.<sup>88</sup>

The resulting mix of damages and penalties shows how important the tool of disgorgement can be. The SEC collects significantly more in disgorgement than it does in civil penalties. In fiscal year 2014, the SEC collected \$1.378 billion in penalties.<sup>89</sup> But during this same period, the SEC collected more than twice as much in disgorgement of illegal profits:

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retains the selfsame proceeds of his wrongdoing.” (quotations omitted)).

87. See Richard F. Albert, *Punishment Without Cause: Disgorgement and Forfeiture of Salary and Pensions*, FORBES INSIDER (April 2, 2014) <http://www.forbes.com/sites/insider/2014/04/02/punishment-without-cause-disgorgement-and-forfeiture-of-salary-and-pensions/> [<https://perma.cc/R7KJ-N8B3>] (noting that SEC frequently seeks to disgorge all salary and bonuses earned during period of alleged violations of securities laws). While the limitation of causal connection is easy to satisfy and courts give the SEC wide latitude, it is not entirely toothless. See, e.g., SEC v. Razmilovic, 738 F.3d 14, 33 (2d Cir. 2013) (ordering disgorgement of bonuses and severance but not of underlying salary that was “not dependent on the company’s performance” and therefore unrelated to the violation).

88. Urksa, Velikonja, *Fair Funds*, 67 STAN. L. REV. 331, 340, n.50 (2014).

89. These figures include both orders from SEC cease and desist proceedings as well as enforcement actions in federal court. SELECT SEC AND MARKET DATA, FISCAL 2014 Table 1 (2014), available at <http://www.sec.gov/about/secstats2014.pdf> [<https://perma.cc/UQ6G-Z2Z4>].

2016]

Zaring.A1Edit

129

approximately \$2.788 billion.<sup>90</sup>

Civil penalties were the vehicle for the change in Dodd-Frank that has made ALJs such a newly important part of the SEC mix. Dodd-Frank increased the size of civil penalties available in the administrative forum, but these are still quite small.<sup>91</sup> More importantly, Dodd-Frank expanded the SEC's ability to impose civil penalties beyond just regulated entities to anyone. The 1990 Act limited the civil penalty power to regulated entities.<sup>92</sup> Dodd-Frank eliminated this distinction, opening the possibility of civil penalties against anyone in violation of the securities laws.<sup>93</sup> And while the statutory penalties are small (though significant to individual respondents), the statute provides that the SEC may seek disgorgement in any proceeding where it seeks a civil penalty.<sup>94</sup>

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90. *Id.*

91. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (Jul. 21, 2010), § 929p (codified at 15 U.S.C. § 78u-3) (allowing imposition of civil penalties but capping maximum penalty available at \$150,000 for a natural person or \$725,000 for a corporation). These penalties represent a 50% increase over the penalties applicable to broker-dealers prior to Dodd-Frank.

92. [FA]

93. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (Jul. 21, 2010), § 929p (codified at 15 U.S.C. § 77h-1(g)).

94. 15 U.S.C. §77h-1(e).

*D. Administrative Adjudication Today*

The SEC's ALJ program has provoked a great deal of consternation since the Dodd-Frank amendments expanding it; but a systematic look at the program in the last half-decade suggests that this consternation can imagine an adjudicative experience that does not exist. The SEC does not always win before its ALJs.<sup>95</sup> Those adjudicators spend most of their time routinely sanctioning very derelict registered companies, broker-dealers, or investment advisors, and not high-profile insider traders or corporate officers. The opinions rendered by ALJs are organized and lengthy, rather than cavalier; they do not look confused, and rather, in many ways, mimic the look and feel of securities law opinions rendered by Manhattan district judges, if not the perspective.<sup>96</sup> Nor has it mattered, at least when the opinions issued since Dodd-Frank, are compared, which ALJ decides which case; there are not adjudicators more likely to rule for the SEC than others. A multivariate logistic regression suggests that the best predictors of success against the agency before ALJs lies in the sort of representation defendants have obtained, and whether they are publicly traded companies alleged to have made errors in their public filings.<sup>97</sup> The picture is in many ways reassuring.

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95. [FA]

96. In Part III of the paper, the different perspectives of corporate lawyers and administrative lawyers will be compared, and found to be quite different.

97. [FA]

2016]

Zaring.A1Edit

131

ALJs do not, on the surface, offer a particularly different form of justice than do federal courts, and they do require the Enforcement Division to be put through its paces. In the end, the government usually wins, but administrative agencies usually win in the federal courts as well.<sup>98</sup>

*1. How Much Has SEC Policy Changed?.*—The agency has turned to administrative adjudication, as one might expect, given Congress’s decision to broaden the jurisdictions of ALJs, but it remains active in district court. The SEC’s Enforcement Director, Andrew Ceresney, has explained that because of the Dodd-Frank amendments, the Commission can “obtain many—though not all—of the same remedies in administrative proceedings as we could get in district court.”<sup>99</sup> Accordingly, he has admitted, “we are using administrative proceedings more.”<sup>100</sup>

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98. David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135, 140 (2010) (observing that, regardless of the standard of review, agencies tend to win roughly two thirds of the cases they litigate in the courts of appeals).

99. Andrew Ceresney, *Remarks to the American Bar Association’s Business Law Section Fall Meeting* <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297> [<https://perma.cc/75D6-CEFF>] (2014). To be sure, the SEC recently issued guidance on how it chooses between filing cases in court and before in-house judges. It emphasized that “[t]here is no rigid formula dictating the choice of forum.” SEC Enforcement Division, *Approach To Forum Selection in Enforcement Actions*, <https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf> [<https://perma.cc/TUA9-LFZH>]. (2015).

100. *Id.*

But this change in policy can be overstated by its critics. More cases are being brought administratively, but most of the proceedings filed before ALJs still involve registered individuals or firms, which have been eligible for administrative proceedings since 1990.<sup>101</sup> It also appears, though it is difficult to detect from aggregate numbers, almost by definition, that the SEC is bringing more high-profile cases of securities fraud and insider trading administratively.<sup>102</sup>

Administrative proceedings are certainly increasing, as are damages. Before 2010, the agency initiated less than 400 administrative claims per year, after 2010, it initiated substantially more than 400; in 2014 it brought 610, a record.<sup>103</sup> Moreover, the use of monetary penalties is new. As former commissioner Paul Atkins has put it, the agency's policy was that "penalties should be assessed against [non-regulated] entities only in the rare situation

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101. [FA]

102. For more on the fuzziness of the SEC's numbers, see Urska Velikonja, *Enforcement Statistics At The SEC*, \_\_ CORN. L. REV. \_\_ (forthcoming \_\_).

103. The number of proceedings brought in the administrative forum each year as reported by the SEC: 2006 (356), 2007 (394), 2008 (386), 2009 (352), 2010 (429), 2011 (469), 2012 (462), 2013 (469), 2014 (610). See SEC, *Financial Report: Fiscal Year 2014*, 51-56, <http://www.sec.gov/about/secpar/secafir2014.pdf#appendix> [<https://perma.cc/XXP9-E6WX>]. But, of course, the SEC's numbers are not something on which we should blindly rely. See Velikonja, *supra note* \_\_ at Appendix.



2016]

Zaring.A1Edit

133

where the entity received a direct economic benefit.”<sup>104</sup> Between 1990 and 2002, the Commission only brought four monetary penalties cases against non-regulated entities, obtaining total damages of less than \$5 million.<sup>105</sup> As we have seen, the SEC imposed \$4.166 billion in fines and penalties in fiscal year 2014.<sup>106</sup>

Although a great deal of attention has been paid to high profile cases directed to ALJs such as those against the flamboyant financier Lynn Tilton and the former McKinsey CEO Rajat Gupta, the mix of traditional cases to new cases has not changed much in aggregate.<sup>107</sup> Of the SEC’s 610 administrative proceedings initiated in 2014, more than half of them in three categories: “broker-dealer,” “delinquent filings,” and “investment advisors” cases.<sup>108</sup> All three of these areas involve regulated entities that were unaffected by the Dodd-Frank changes to the administrative cease and desist proceedings. These are areas where the SEC traditionally brings

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104. Paul S. Atkins & Bradley J. Bondi, *Evaluating The Mission: A Critical Review Of The History And Evolution Of The SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 390 (2008).

105. Ryan Jones, *The Fight for Home Court: An Analysis of the SEC’s Increased Use of Administrative Proceedings* (April 7, 2015). SMU L. REV., Forthcoming. Available at SSRN: <http://ssrn.com/abstract=2589703> [<https://perma.cc/6LYS-29LV>] at 9.

106. See *infra* notes 89–90 and accompanying text.

107. See *supra* notes 5–16 and accompanying text.

108. SELECT SEC AND MARKET DATA, FISCAL 2014, Table 2.

comparatively few civil actions in federal court.<sup>109</sup>

The SEC has brought some administrative actions in cases that are traditionally associated with civil enforcement in federal court, although this is not unprecedented. For example, 2014 featured 12 administrative proceedings brought for insider trading.<sup>110</sup> But the SEC brought 10 insider trading cases in the administrative forum in 2007, meaning that the defendants then would have been accountants, broker-dealers, or investment advisers.<sup>111</sup> On the other hand, its use of the proceedings to hear foreign corrupt practices cases is new, although the number of such cases brought per year are in the single digits.<sup>112</sup>

The SEC's new policy is to engage in more administrative enforcement across the board, but the raw data does not suggest that it has committed itself to stop filing cases in federal court.

2. *SEC Administrative Proceedings Since The Enactment of Dodd-Frank: An Analysis of Five Years of Initial Decisions.*—It could, however, be the case that the matters brought before the ALJs enjoyed a strong home court

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109. For example, in 2014, the SEC brought 159 cease and desist proceedings against broker-dealers, but just 7 actions in federal court.

110. [FA]

111. SELECT SEC AND MARKET DATA, FISCAL 2007, Table 2.

112. *Id.*

2016]

Zaring.A1Edit

135

advantage, and, further it could be the case that the experiences for defendants would differ between federal court and administrative proceedings. As far as the processes between the two jurisdictions go, there is little doubt that the differences are distinctive—the four month rocket docket alone requires it, as do the rules of evidence, the lack of a jury, and the like.<sup>113</sup>

But outcomes—and some aspects of the administrative procedure as well—can be examined with data. I collected the initial decisions of ALJs issues since the passage of Dodd-Frank and early 2015 and analyzed them both qualitatively and quantitatively to see what they could reveal about administrative proceedings.

*a. Data and Caveats.*—Between March 27 2015, and the passage of the statute in July 22, 2010, SEC ALJs have issued 359 initial judgments.<sup>114</sup> All of these decisions were collected and read. They were coded for the representation of the defendant (pro se, represented,<sup>115</sup> or uncontested), the

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113. See *supra* Part I.B for a discussion of these differences.

114. This means that the opinions of ALJs can be considered, but these offer only a partial, and likely picture of what the universe of administrative proceedings suggests. For a dataset collected in 2007-09, “[d]efendants settled with the SEC in 90 percent of all cases in the dataset assigned to administrative proceedings.” Stavros Gadinis, *The Sec and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 698 (2012).

115. It was difficult to identify whether and how attorney quality varied. See *infra* note 128

identity of the ALJ who wrote the decision, the statutory basis for the SEC's complaint, and whether the SEC "won," that is, whether it received all the relief it sought, codes as a 1,0 variable. The exceptional cases—where the SEC comprehensively lost—are also considered qualitatively, but if they claim is that the SEC always wins before its ALJs, then assessing whether that claim is in fact the case is an appropriate test.

Some have criticized the SEC's use of administrative forums and alleged that the agency never loses before its own ALJs. In fiscal year 2014, the SEC won every administrative case that went to a judgment, including all fourteen cases that went to trial.<sup>116</sup> The SEC has not been uniformly successful however, comprehensively losing cases in the administrative

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and accompanying text.

116. Jenna Greene, *The SEC's On A Long Winning Streak*, THE NATIONAL LAW JOURNAL Jan. 19, 2015. By contrast, in 2014, the SEC conducted 17 federal court trials and lost 7. Bruce Carton, *SEC Riding Lengthy Unbeaten Streak in Administrative Proceedings*, COMPLIANCE WEEK Jan. 20, 2015, <https://www.complianceweek.com/blogs/enforcement-action/sec-riding-lengthy-unbeaten-streak-in-administrative-proceedings> [<https://perma.cc/5MVG-XWPG>].

2016]

Zaring.A1Edit

137

forum in 2011,<sup>117</sup> twice in 2013,<sup>118</sup> and 2015.<sup>119</sup> Much more often, it fails to get all the relief it seeks; graded on that tough curve, the agency only received all the remedies it sought in 71% of the initial decisions in the sample.

Analyzing these texts offers some insights into administrative proceedings, but not comprehensive ones. As with any project where adjudicative opinions are analyzed, those cases that settled, or that were never brought, are excluded from the data. Accordingly, the SEC's win rate in cases tried to an initial decision might reflect a high rate of success, or undersell how high the rate is. Moreover, the sample is not large, and there

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117. In re John P. Flannery and James D. Hopkins, SEC Decision No. 438 (Oct. 28, 2011) (finding no violation of securities laws after lengthy administrative hearing where SEC alleged material misstatements to shareholders). *See also* Alison Frankel, *SEC Loses Again: Agency Judge Clears State Street Execs*, Thomson Reuters News and Insight Oct. 31, 2011, <http://blogs.reuters.com/alison-frankel/2011/10/31/sec-loses-again-agency-judge-clears-state-street-execs/> [<https://perma.cc/NYK9-DVHE>].

118. In the Matter of Miguel A. Ferrer, Initial Decision Release No. ID-513, File No. 3-14862 (10/29/2013); SEC, ALJ Initial Decision, In the Matter of S. W. Hatfield, Initial Decision Release No. ID-504, File No. 3-15012 (09/10/2013); SEC, ALJ Initial Decision, In the Matter of Jilaine H. Bauer, Initial Decision Release No. ID-483, File No. 3-15020 (04/16/2013).

119. In re Thomas R. Delaney II and Charles W. Yancey, SEC Decision No. 755 (Mar. 18, 2015) (finding no supervisory liability for one respondent in a Rule 204 case that went to administrative hearing). *See also* Aruna Viswanatha, *Amid Cries of Home Field Advantage, SEC Loses Case in In House-Court Court*, WALL ST. J. Mar. 19, 2015, <http://blogs.wsj.com/moneybeat/2015/03/19/amid-cries-of-home-field-advantage-sec-loses-case-in-in-house-court/> [<https://perma.cc/LK3Q-9DPH>].

is no instrument or discontinuity design to the logistic regression analysis that follows, which would be a better practice. And variable collection exercises are always subject to omitted variables. The results here are only suggestive.

Nonetheless, the analysis is worth doing because of the allegations that have been leveled against administrative proceedings. If the SEC always wins before ALJs, as the corporate bar has complained, the proportion of times it received all of the relief it sought should be very high, and if the agency loses a substantial number of cases, that is relevant as well. If defendants claim that ALJs fail to offer them due process, as they have, then a consideration of the opinions, where they describe how the proceeding unfolded, is relevant, and can usefully be compared to the opinions of federal judges.

The ALJs who work for the SEC do not begin their time there as securities laws experts. Six adjudicators worked in the office during the period during which the sample of initial decisions was taken. All of these judges were lawyers; the legal educations offered by the group included law degrees from Harvard, Ohio State, Columbia, Boston University, Loyola University of Chicago, and the University of Pennsylvania. Three of the ALJs served as litigators at the Department of Justice, with no obvious expertise in securities cases. Of these three, two handled a broad array of civil matters, while one took on military cases, including military discipline proceedings conducted at courts martial. One ALJ worked at the Department

2016]

Zaring.A1Edit

139

of Labor, another at the FCC. One ALJ, the one who had by far the most background in securities-like litigation, worked for some time at the Commodities Future Trading Commission, a financial market regulator that does work not dissimilar to the SEC.<sup>120</sup>

But most of these ALJs spent time as agency judges before arriving at the SEC. The adjudicator with financial regulatory experience based on his time at the CFTC began his time as an adjudicator with the Social Security Administration, as did at least one other judge (the vast majority of ALJs begin their career at the SSA, which employs the vast majority of federal judges. Another spent 20 years as an ALJ at the Department of Labor before joining the SEC.<sup>121</sup> As relative newcomers to securities work these adjudicators did not come with a depth of knowledge about the nature of securities litigation or administrative proceedings at the SEC; nor would they have been known, and held in particular esteem, by the securities bar upon appointment.

A table of summary statistics shows how the dataset of initial decisions broke down, and indeed it contains much of the information that will be of interest to those not statistically inclined.<sup>122</sup>

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120. [AU2] See email to EIC

121. Detailed biographies beyond their legal education were not available for the two most experienced judges (whose appointing press releases are not archived on the internet).

122. I collected and coded the data, with assistance from one research assistant, and received

[Table 1 will be reinserted]

*b. Qualitative Overview.*—The look and feel of these opinions is, in most cases, one of a standardized template, which is unsurprising, given that ALJs initial decisions are required to be thorough: the initial decision must include “findings and conclusions, and the reasons or basis therefore, as to all the material issues of fact, law or discretion presented on the record” in addition to any order for relief.<sup>123</sup>

Initial decisions accordingly follow a pattern. ALJs begin with an overview, continue with a recounting of the facts, sometimes at great length, followed by a turn to the law, which is then applied to the facts, after which sanctions are discussed (except in the rather rare case where none are imposed), and concluding with an order. Even the citations are standard: a leading case on the factors to be considered when imposing sanctions, *SEC v. Steadman*, was cited in 239 of the 376 opinions in the sample.<sup>124</sup> The opinions cluster around predictable matters; the modal basis for an opinion revokes the registrations of a company that had filed to meet its filing obligations.

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assistance with the statistical analysis from a graduate student in the university’s economics department.

123. 17 C.F.R. § 201.360(b).

124. *SEC v. Steadman*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff’d on other grounds*, 450 U.S. 91 (1981).



2016]

Zaring.A1Edit

141

But by citing a standard set of administrative and judicial decisions, along with agency rules and regulations, engaging in a comprehensive discussion of the facts found in the proceedings, the ALJs always produce a substantial record for review by the commission and the courts. A short opinion revoking the registrations of companies might still produce almost 1800 words, about the length of two op-ed columns.<sup>125</sup> A longer opinion might reach over 48,000 words, the length of a short book.<sup>126</sup> The average length of an initial decision is 6,800 words.

The lawyers who contest these cases vary between sole practitioners, and big firm or boutique litigators who may also represent their clients in court as well.<sup>127</sup> Very large firms, even if they feature very large securities practices, certainly do not monopolize the administrative courtroom.<sup>128</sup> No

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125. SEC, ALJ Initial Decision, *In the Matter of Pro-Tech Industries, Inc.*, Initial Decision Release No. ID-612, File No. 3-15885 (2014).

126. SEC, ALJ Initial Decision, *In the Matter of BDO China Dahua CPA Co., Ltd.*, Initial Decision Release No. ID-553, File Nos. 3-14872, 3-15116 (2014) (over compliance with SEC investigations into fraud at listed Chinese companies).

127. SEC, ALJ Initial Decision, *In the Matter of Anthony Chiasson*, Initial Decision Release No. ID-589, File No. 3-15580 (2014) (represented by the white collar criminal defense boutique Morvillo & Abramowicz); SEC, ALJ Initial Decision, *In the Matter of Thomas R. Delaney II*, Initial Decision Release No. ID-755, File No. 3-15873 (represented by Hayes & Boone).

128. In my sample, Wilmer Hale, one of the largest law firms in the country, with one of the largest securities practices, appeared only twice. The law firm rating service Chambers & Partners put Wilmer in its top rank of securities regulation practices in 2015. Chambers & Partners, *Securities*

lawyer or firm appeared in more than a handful of cases during this period. In 69 proceedings, the defendant appeared pro se, in 108, the defendant had representation.

A variety of Enforcement Division lawyers appeared in proceedings that resulted in opinions, but some of them certainly had more experience than their private sector counterparts with the forum; one David Frye appeared in 64 of the proceedings in the sample, most of which involved default proceedings revoking registrations.

The initial decisions are often routine. In many cases they revoke the registrations of companies that do not appear before the agency. The default judgments that inevitably follow are nonetheless expansive, with fact-finding and legal analysis in each decision. In the sample, 182 of the 359 decisions were rendered after a default.

In other cases, the administrative proceedings follow judicial proceedings that have already resulted in adverse verdicts for the defendants for violating the securities or the criminal laws. This questions resolved in the follow-on administrative proceeding concern the imposition of further sanctions on those defendants. The Enforcement Division may seek collateral bars from participation in the securities markets (or parts of those

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– *Nationwide*, [http://www.chambersandpartners.com/12788/1127/editorial/5/1#3675\\_editorial](http://www.chambersandpartners.com/12788/1127/editorial/5/1#3675_editorial) (“a standout performer in the regulatory sphere with impressive depths of quality on both the advisory and enforcement sides”).

2016]

Zaring.A1Edit

143

markets) for a term of years or permanently. These proceedings are also ordinarily straightforward, although in some cases ALJs will pare back the sums sought by the Enforcement Division.

While most initial decisions concern mundane filing problems, high profile cases that have recently been routed towards the ALJs. For example, the agency's decision to prosecute the Chinese subsidiaries of the big multinational accounting firms for failing to assist investigations analyzing fraud allegations made against various Chinese corporations was handled administratively, and fell within the sample.<sup>129</sup> That case consistent with the traditional expertise of ALJs in administering the sanctions regime for accountants licensed to practice before the commission.

Other high profile cases exemplify the sorts of follow-on proceedings that the agency commonly pursues after winning a securities fraud cases against a defendant in federal court. Both of the hedge fund managers prosecuted for insider trading in the litigation that resulted in the Second

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129. SEC, ALJ Initial Decision, *In the Matter of BDO China Dahua CPA Co., Ltd.*, Initial Decision Release No. ID-553, File Nos. 3-14872, 3-15116 (2014) (enforcement initiated due to firms failing to "produce any audit work papers" for clients subject to SEC investigations; the firms argued that Chinese law prohibited them from producing the materials). The suspensions issued by the judge created an international incident. See Todd Rappoport, *Judge Suspends Chinese Units of Big Four Auditors*, WALL ST. J. Jan. 23, 2014, <http://www.wsj.com/articles/SB10001424052702303448204579337183810731744> [<https://perma.cc/7Z4M-ZTJT>].

Circuit's groundbreaking *Newman* decision were brought up on administrative proceedings that resulted in initial judgments.<sup>130</sup> After being convicted in federal court, also one of the defendants in the Galleon hedge fund case faced follow-on administrative proceedings, all of which also fell within the sample.<sup>131</sup>

Moreover, standalone cases outside the sample that could have been brought in federal court have also been brought internally; a trader made infamous by Michael Lewis's book on the financial crisis, *The Big Short*, also generated an opinion by an ALJ; that securities fraud case did not follow proceedings in federal court.<sup>132</sup> And we have already noted other such

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130. SEC, ALJ Initial Decision, *In the Matter of Anthony Chiasson*, Initial Decision Release No. ID-589, File No. 3-15580 (2014); SEC, ALJ Initial Decision, *In the Matter of Todd Newman*, Initial Decision Release No. ID-562, File No. 3-15581 (2014).

131. SEC, ALJ Initial Decision, *In the Matter of Michael S. Steinberg*, Initial Decision Release No. ID-690, File No. 3-15925 (2013). For a discussion of the case, see Michelle Celarier, *SAC PRO GUILTY! Feds Nail Steinberg On Insider Trading Charges*, N.Y. POST, Dec. 19, 2013, 2013 WLNR 31720895.

132. SEC, ALJ Initial Decision, *In the Matter of Harding Advisory LLC*, Initial Decision Release No. ID-734, File No. 3-15574 (2014) (concerning "allegations of fraudulent misrepresentation involving the purchase of assets for collateralized debt obligations"). As Reuters put it, "In October, the regulator charged collateral manager Harding Advisory LLC and its owner Wing Chau, a character in Michael Lewis' book "The Big Short," with fraud in connection with the Octans CDO." *Bank Of America's Merrill To Pay \$132 Million In SEC Case Over Mortgages*, REUTERS, Dec. 12, 2013, <http://www.reuters.com/article/2013/12/12/us-sec-bankofamerica->

2016]

Zaring.A1Edit

145

cases.<sup>133</sup>

The SEC certainly does well in these proceedings. But its record is not unblemished. As we have observed, the agency received everything it asked for only 70% of the time; that is not too different than the rule of thumb rate for victories by any federal agency in federal court.<sup>134</sup>

Of course, there is not getting everything the agency asks for, and there is losing the case. It is true that SEC ALJs are willing to reduce the remedies sought by the agency's Enforcement Division, either by reducing the amount of money that the defendant must pay to the SEC or by reducing the length of their bar from practicing before the agency.

But in my sample, the SEC rarely lost cases that it pursued to the point at which an ALJ would issue a decision. I identified only six of the first 359 decisions issued since Dodd-Frank was enacted that rejected the arguments of the Enforcement Division wholesale.

In two of these cases, the ALJs refused to punish relatively small time violators more than they had already been punished. One featured an accountant who had failed to update his registration and was later

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merrill-settlement-idUSBRE9BB11620131212 [<https://perma.cc/3BLX-2AF2>]. *See also* notes 1–4, *supra*, for other examples.

133. *See supra* notes 5–16 and accompanying text.

134. [FA] [AU3], *See Zaring, Reasonable Agencies, supra note ??, at 140.*

permanently barred from practice.<sup>135</sup> The ALJ declined to add to his woes by sanctioning him for completing audits while his registration had lapsed. A second opinion declined to impose further penalties against a defendant who had already incurred penalties well beyond his ability to pay.<sup>136</sup>

In the other four cases, however, the defendants were high profile and well represented. Perhaps most notably, in 2011, an ALJ rejected a case against employees of State Street for misleading investors about the extent of subprime mortgage backed securities held in an unregistered fund.<sup>137</sup> That case set back the SEC's efforts to hold more bankers liable for fraud in the run-up to the financial crisis, and cannot be characterized as a politically popular or supine opinion; indeed, the SEC commissioners themselves, over two dissents, overruled the opinion on appeal.<sup>138</sup>

Two other cases excused defendants charged with failing to supervise their subordinates, both of whom were engaged in work designed to comply with SEC rules. One featured a partner at Ernst & Young; the partner's

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135. SEC, ALJ Initial Decision, In the Matter of S. W. Hatfield, Initial Decision Release No. ID-504, File No. 3-15012.

136. SEC, ALJ Initial Decision, In the Matter of David Mura, Initial Decision Release No. ID-753, File No. 3-15045.

137. SEC, ALJ Initial Decision, In the Matter of John P. Flannery, Initial Decision Release No. ID-438, File No. 3-14081.

138. SEC, Commission Opinion, In the Matter of John P. Flannery, Release Nos. 33-9689, 34-73840, IA-3981, IC-31374, File No. 3-14081.

2016]

Zaring.A1Edit

147

subordinate was barred from practicing before the SEC for one year.<sup>139</sup> In the other, charges against the CEO of a large, multinational clearing firm were dismissed for his own failures to supervise his chief compliance officer.<sup>140</sup>

A final case against relatively high level UBS financial advisors in Puerto Rico was deemed unproven.<sup>141</sup>

I draw two conclusions from these opinions. The first is that these adjudicators do, in fact, usually rule in favor of the agency if they must issue a decision. But on the other hand, they are capable of reprimanding the agency, and, as the State Street case showed, cutting back on an enforcement priority.

Much of the agency's success before the ALJs, moreover, can be attributed to the routine nature of most of the cases filed administratively.<sup>142</sup>

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139. SEC, ALJ Initial Decision, In the Matter of Gerard A.M. Oprins, Initial Decision Release No. ID-411, File No. 3-13797.

140. SEC, ALJ Initial Decision, In the Matter of Thomas R. Delaney II, Initial Decision Release No. ID-755, File No. 3-15873.

141. SEC, ALJ Initial Decision, In the Matter of Miguel A. Ferrer, Initial Decision Release No. ID-513, File No. 3-14862.

142. As we have seen, ALJs write a number of opinions revoking the registrations of companies who fail to file quarterly reports; often these companies do not bother to defend themselves, making revocation all but certain. They also preside over proceedings that follow on from trials in which the defendants were found to have committed securities fraud. The practices bars imposed by ALJs

One concern regularly raised about the independence of ALJs has focused on their supervision by the agency's commissioners. There is little question that ALJs, as a general matter, enjoy a marked degree of formal independence from the agency for which they work, including all of the protections of independence set forth in the APA.<sup>143</sup> However, appeals from their initial decisions go to the commission itself.<sup>144</sup> It could use searching review to constrain what ALJs do.

We can get a sense of how independent ALJs are by looking at the review done by the commission of our sample of initial decisions.<sup>145</sup> If we leave out ministerial affirmances, based on a failure to perfect an appeal, commission review looks quite searching, even as it only is one for approximately one out of six cases. One of the incantations of the commissioners, repeated at the beginning of many of its decisions, is that their decision would be based on an "independent review of the record."<sup>146</sup>

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in the aftermath of these verdicts are fait accomplis.

143. [FA]

144. [FA]

145. The review is not perfect, as the commission had not finished reviewing all of the potential cases from the data set by the end of 2015. Moreover, some appeals are affirmed by default. That is when a defendant is found liable in the initial decision, and then either fails to file an appeal in which case the decision becomes final or files a notice of appeal but fails to perfect their claim with full briefing.

146. [FA] [AU4] **Of the 197 initial decisions reviewed by the commission in the five years,**



2016]

Zaring.A1Edit

149

Ordinarily their decisions were lengthy enough to include a statement of facts, a legal analysis, and an evaluation of the appropriate form of relief.

Appeals where the commission made some substantive decision could be identified in 55 cases. In 29 of these decisions, the commission affirmed the initial decision of the ALJ. In eight decisions the commission affirmed the decision directionally but modified the remedy. In 18 cases, the commission reversed the decisions of the ALJs. Overall in those cases where the commission has completed its review, it reversed or modified the judgments of the ALJs slightly less than half of the time.

The grounds for affirmance ranged from summary shorthand recitations used to justify the more ministerial decisions (of, say, a failure to file that had not been remedied by the time the appeal was heard) to lengthy opinions vindicating the findings and conclusions of law of the ALJ. The commission would modify cases by recalculating the remedy, perhaps to increase a fine or lower it, sometimes very slightly,<sup>147</sup> or to take a different position on a conclusion of law drawn by the judge.

The cases reversing the ALJ occasionally required little analysis. If the

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46 included that term, and others included terms like it, [https://www.bloomberglaw.com/legal\\_search/results/94402b6b2af9b2f64a51482e505c1b6d](https://www.bloomberglaw.com/legal_search/results/94402b6b2af9b2f64a51482e505c1b6d). prior to December 8, 2015,

147. In the sample, the commissioners were more likely to recalibrate the fine than to change other sanctions, like the length of a ban from practicing in the industry.

agency proceedings had followed a federal court claim and were premised on either a conviction or a liability finding, and that conviction or liability finding was reversed on appeal, the administrative proceedings would be summarily reversed as well, usually on the motion of the Enforcement Division. In some cases the commission behaved more leniently to defendants than did the administrative law judges.

But in cases where defendants did appeal, the agency often did so as well, seeking more severe sanctions than those imposed by the ALJ. On those occasions where the administrative law judges ruled against the enforcement division, the commission took an especially careful look. It reversed the leniency shown to Hatfield<sup>148</sup> and Flannery.<sup>149</sup> But it never exclusively played the role of the bad cop; it sympathized, as did the ALJ, with Mura's

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148. [FA]

[AU5]

<https://www.bloomberglaw.com/s/legal/7fcdf0fd52feca66ed8069928ef2b65c/document/X11SQ2PC?search32=C9P6UQR5E9FN6PB1E9HMGNRKCLP6QF92D5N6IT39C5M20P35CDKN6QBFDOH20GAE8GG6GOBKCPKMAR347CTMSRQVD5MN0NRGD1P62SR5ECUJ2EPRCPKNGNR2DTNMONRHELIN4U9T64>

149.

<https://www.bloomberglaw.com/s/legal/563593940f998125dd09afae1ef3c72a/document/X156ITHC?search32=C9P6UQR5E9FN6PB1E9HMGNRKCLP6QF92D5N6IT39C5M20P35CDKN6QBFDOH20GAE8GG6CR31DPN6ASJP7CTMSRQVD5MN0NRGD1P62SR5ECUJ2EPRCPKNGNR2DTNMONRHELIN4U9T64>

2016]

Zaring.A1Edit

151

penurious plight.<sup>150</sup>

We can also look for reviews in the courts of appeals of actions that began as initial decisions by ALJs. This was as a general matter exceedingly uncommon, indeed only two cases: *Pierce v. SEC*<sup>151</sup> and *Sirri v. SEC*,<sup>152</sup> have resulted in reported decisions so far.<sup>153</sup> *Pierce* was a straightforward affirmance, albeit a reported one, of the SEC's actions; it reviewed both the decision of the ALJ and the review by the Commission. *Sirri* also straightforwardly affirmed the decision of the SEC, and conducted a similar inquiry. Although definitive conclusions would be premature, the lack of

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150. [FA]

<https://www.bloomberglaw.com/s/legal/0af3832cb77f7e79ec1ce48ce1bd6ef0/document/X1Q6T9C?search32=C9P6UQR5E9FN6PB1E9HMGNRKCLP6QF92D5N6IT39C5M20P35CDK N6QBFDOH20GAE8GG6QTBIC4TJMRJFBTKMQS2VE1K74OBYCLPJQC9R7DJ6IU2V C9NMUR2VE5QMASJP7KOG>

151. 586 F.3<sup>rd</sup> 1027 (D.C. Cir. 2015).

152. 773 F.3d 89 (D.C. Cir. 2014).

153. However, the accuracy of the study of appellate review should not be overstated. Many cases have not yet wended their way through the courts of appeals. More importantly, because of the lack of a procedural history system in the relevant legal databases for administrative claims appealed to the federal courts, these cases were identified only from reported cases released by the courts on Bloomberg's federal appellate court database that included the SEC as a defendant over this period; that database may not have captured unreported decisions, although it is generally quite comprehensive. Also, there may have been some cases in which the captioning was idiosyncratic and a mere title search should not be considered to be comprehensive.

regular appellate review suggests that dialogue with the federal courts is more likely to happen through parallel or follow-on enforcement actions; as we have seen, the Commission frequently reverses its ALJs when it receives news of an adverse judicial opinion in a parallel proceeding after the ALJ has filed an initial decision.

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2016]

Zaring.A1Edit

153

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*c. Quantitative Analysis.*—A t-test (t-tests compare the means of variables) indicated, unsurprisingly, that there is evidence suggesting that cases that are contested are more likely to be lost by the SEC, though no causal inference can be drawn from this. Factors relevant to understanding the SEC win rate could be estimated through logistic regression, which is appropriately used when the dependent variable is categorical with two levels (in this case, yes, or no). A univariate regression of case outcome against ALJ does not support any inference that the ALJ authoring the opinion was associated with different the likelihoods that the SEC would win the case.<sup>157</sup> However, there is evidence that the choice by the defendant to be represented by council is associated with a significantly lower win-rate for the SEC. Finally, a multivariate logistic regression of case outcome against, ALJ, case

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157. The coefficient on (now-retired) Judge Mahony is significant at the 10% level, but using ANOVA to examine the differences jointly, the p-value on the joint test of difference is 0.1429 (insignificant). Similarly performing the likelihood ratio F-test on joint significance of any judge is insignificant (p=0.2059).

section, and choice of representation level revealed, unsurprisingly, that representation still mattered—the SEC wins essentially all the time (98.9%) when the defendant has no representation, but receives all of the relief it seeks only 71% of the time when the case is fully contested.<sup>158</sup>

Furthermore, section 12(j) cases, which the SEC uses to revoke the registration of securities of a publicly traded company for, usually, failing to file reports, are decided in favor of the SEC significantly more frequently than any other type of statutory authority under which the agency brings cases, with no other cases exhibiting significant differences from each other. This different nature of filing problems cases cannot entirely be explained by differences in the rate of contested cases/pro-se cases, as shown in by regressions (5) and (6) in the Table 1 of the appendix.

However, these inferences are certainly not causal. The choice to contest a case, let alone to contest it to the point where the ALJ issues an initial decision, is related to the expected outcome of a challenge, with cases defendants feel more likely to win being more appealing to contest. We can only say that representation is related to the outcomes expressed in initial decisions, and that our study does not suggest, on simple quantitative metrics alone, that any particular SEC ALJ is more likely to favor the agency than others when they write opinions.

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158. [AU6] This is from the quantitative data

2016]

Zaring.A1Edit

155

3. *Comparing SEC ALJs to Article III Judges.*—An additional way to examine the administrative adjudication within the SEC and adjudication in federal court is to compare the work of the epitome of what the defense bar looks for in trial court adjudication. The Southern District of New York, which covers Manhattan, is ground zero of securities enforcement in the federal courts.<sup>159</sup> Judge Jed Rakoff of the Southern District of New York, a former securities fraud prosecutor who has long expressed a willingness to challenge government cases exemplifies the sort of judge who is vested with independence by Article III, but has a sophisticated sense of how the securities laws might work, and is a jurist before which the SEC repeatedly appears.<sup>160</sup>

The initial judgments issued by ALJs, the cases decided by all SDNY judges, and the cases decided by Judge Rakoff that touched on securities law since the passage of the Dodd-Frank Act can be compared quantitatively.

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159. [FA]

160. Indeed, Judge Rakoff, who has taken senior status, has the power to increase the proportion of securities cases he hears, by declining to hear criminal cases, which senior judges are controversially permitted to do. See Stephen B. Burbank et. al., *Leaving the Bench, 1970-2009: The Choices Federal Judges Make, What Influences Those Choices, and Their Consequences*, 161 U. PA. L. REV. 1, 36 (2012) (“senior status provided a means for judges to avoid what some perceived as the agony of imposing unjust sentences required by the Sentencing Guideline”).

Specifically the 359 initial decisions issued by ALJ between March 27 2015-July 22, 2010 to opinions in securities cases issued by our comparison judges.<sup>161</sup> During that same period, Judge Rakoff has issued 48 securities decisions.<sup>162</sup> SDNY judges issued 786 securities law decisions.<sup>163</sup>

The tribunals' various citation practices speak to the increasingly distinct securities law jurisprudences being developed by ALJs and the federal judiciary. Administrative law judges cite to previous administrative precedent more often. A typical initial judgment will have 8.6 cites to other reported SEC decisions. SDNY judges cited to ALJ opinions 9 times during this period, approximately .01 citations per opinion. Judge Rakoff almost never cites to administrative adjudications either. On average, in his 48 securities opinions, he would cite .04 administrative adjudications per opinion, a number that closely approximates zero.<sup>164</sup>

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161. This means that the opinions of ALJs can be considered, but these offer only a partial, and likely picture of what the universe of administrative proceedings suggests. For a dataset collected in 2007-09, "[d]efendants settled with the SEC in 90 percent of all cases in the dataset assigned to administrative proceedings." Stavros Gadinis, *The Sec and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 698 (2012).

162. Per Bloomberg Law's securities database, <https://www.bloomberglaw.com/p/3547e197a47ea5a9012e1f7601f0b538/search/results/ddbccf8bde0a381326904466460e171>.

163. *Id.*

164. [AU7] This is also from the quantitative data



2016]

Zaring.A1Edit

157

But if federal judges do not care about the administrative decisions of the SEC, the contrary is not the case. ALJs cited to the Federal Reporter's Third Edition after the passage of Dodd-Frank roughly 3.8 times per opinion. That number paled in comparison with Judge Rakoff's citations, which amounted to 14.8 Federal Reporter citations per opinion. Southern district judges as a whole cited to the F.3d 13,673 times in their securities law decisions of the same period, or 17.4 such cited per opinion. But, of course, ALJs do not have to set forth the procedural citations, such as the standard of review for a particular motion, that are part and parcel of any federal court opinion.<sup>165</sup>

In other ways, the opinions look similar. ALJs write on average 6200-word decisions since Dodd-Frank. Judge Rakoff securities law opinions have amounted to 8900 words, while the SDNY bench as a whole has averaged 12500 words per opinion. The Flesch-Kincaid Reading Ease Test score, which measures the complexity of writing in a given text, are remarkably similar.<sup>166</sup> While the Harvard Law Review has a Flesch-Kincaid

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165. [AU8] SEC ALJs are instead bound by the agencies Rule of Practice, <https://www.sec.gov/about/rulesofpractice.shtml>

166. For discussions and use of Flesch Kincaid Readability Scores, see Daniel Schwarcz, *Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection*, 61 UCLA L. REV. 394, 421 (2014) ("most states do require policies to meet a specific quantitative readability score, usually a fifty or forty on the Flesch-Kincaid Reading Ease Score"); Florencia Marotta-Wurgler & Robert Taylor, *Set in Stone? Change and Innovation in Consumer*

score in the 30s,<sup>167</sup> and sentences with Flesch-Kinkaid scores of approximately 100 could be understood by an average fifth grader,<sup>168</sup> the combined decisions of administrative law judges had a Flesch-Kinkaid score of 61.8, while Judge Rakoff's securities law decisions over the same period had a very similar score of 62.1; SDNY judges registered as very slightly easier to read; they came in at 63.4.<sup>169</sup>

Other reading ease scores (there are four typically-used tests, including the Gunning Fog Index, the Coleman Score, the SMOG Index and Automated Scores) are were all also very closely related.

Although these measurement rubrics may be imprecise, the implications are straightforward enough. It is not easy to detect enormous differences between ALJs, SDNY judges, and Judge Rakoff's securities law opinions other than the fact that federal judges are uninterested in the work of administrative adjudicators, an institutional focus not shared by the

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*Standard-Form Contracts*, 88 N.Y.U. L. REV. 240, 285 (2013) (measuring standard form contracts); Joshua E. Perry et. al., *Direct-to-Consumer Drug Advertisements and the Informed Patient: A Legal, Ethical, and Content Analysis*, 50 AM. BUS. L.J. 729, 778 (2013) (using the scores to measure the readability of prescription drug advertisements). For an overview of how the tests work, see WILLIAM H. DUBAY, *THE PRINCIPLES OF READABILITY* 23 (2004), available at <http://www.impact-information.com/impactinfo/readability02.pdf> [<https://perma.cc/5TRB-NPPZ>].

167. [FA] these should be findable from the materials above, particularly the dubay

168. [FA] ditto (but I don't mind if you find something else

169. [AU9] This is from the quantative study.

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159

adjudicators themselves.

To compare the favorability of judicial enforcement to administrative proceedings for the agency, I identified the cases in the district during the period where the SEC brought enforcement claims against defendants.<sup>170</sup> Of the 119 such cases, the agency's success rate was high; successful outcomes in 111 of the cases could be tracked. Thirty-six Southern District judges heard cases during this period, and none of them were particular outliers in their small samples with regard to whether they voted with the SEC. Indeed, the only notable distinction was that Judge Rakoff heard 13 cases during the period—almost twice as many as did the next most active federal judge on SEC cases, Judge Shira Scheindlin with seven. The cases were almost evenly split between claims brought under 15 U.S.C. 77 (54 of the 119 cases were reported under that statute), and 15 U.S.C. 78m(a) (64 cases were brought under that statute), and the SEC's rate of success did not particularly differ between the two causes of action.<sup>171</sup>

Over the sample period, these results do make the SEC look like a strong enforcer regardless of the forum in which it chose to pursue enforcement; there is no statistically significant distinction between the rates of success.

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170. Bloomberg's data on federal case dockets in the Southern District was used to track the cases, the cause of action, the judge, and the outcome.

171. One docket was brought pursuant to 15 U.S.C. 1, antitrust litigation within the SEC's purview.

Nonetheless, the agency must worry not only about whether it is winning its routine cases, but whether it is winning the high profile ones, and with 8 failures in Manhattan, compared to only 6 over a larger number of enforcement proceedings brought before its ALJs, it may have had some reason to feel like the differences between the fora mattered not just for procedural reasons, but also for the sort of vindication the agency could expect by its choice.

4. *Conclusion.*—ALJs have been the subjects of controversy before the SEC’s change in enforcement policy—many administrative lawyers think of them as costly and uncooperative; the corporate bar appears to believe that it cannot win before them.<sup>172</sup> A close investigation of the initial decisions rendered by the adjudicators since the enactment of Dodd-Frank provides a clearer picture of what is going on in modern administrative adjudication. To deem it vibrant would require more comparisons, perhaps across agencies. But at the SEC, administrative proceedings are elaborated in the way that federal court orders and opinions are, and do not look like *faits accompli*.

## II. The Highly Uncertain Case Against ALJs

The constitutional arguments against the agency’s new policy to bring more cases before ALJs range from a novel separation of powers claim that

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161

has prompted most of the suits against the agency, to more traditional, if rarely vindicated, claims about due process, the right to a jury trial, and equal protection. All are creative enough, but are, as a matter of doctrine, without merit.<sup>173</sup>

The appropriate way to review the agency's policy to route cases to ALJs is either as a matter committed to the agency's discretion, or possibly as a matter to which the agency is entitled to deference for any reasonable interpretation of its governing statute.<sup>174</sup> Because the agency's policy of

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173. There is little scholarly literature on the precise question yet, but Harvard's Adrian Vermuele and Yale's Jonathan Macey have suggested at a forum that they also think the constitutional arguments made by defendants are weak. Stephanie Russell-Kraft, *Why Challenges to SEC Admin Court Will Likely Keep Failing*, LAW360.COM (Mar. 6, 2015, 8:04 PM), <http://www.law360.com/articles/628601/why-challenges-to-sec-admin-court-will-likely-keep-failing> [<https://perma.cc/UA4V-37SM>] (Vermuele expresses confidence that Supreme Court would hold the program constitutional; Macey grudgingly agrees). The best case positing the unconstitutionality of the existence of an enforcement process among ALJs requires a claim about its uniqueness, rather than its typicality. Although plaintiffs have not brought these sorts of cases, the fact that SEC ALJs now have the power to impose strong civil sanctions – sanctions that, by ending careers, and clawing back compensation looks quasi-criminal – on individuals whose engagement with the agency's regulatory scheme is limited to their mere participation in the capital markets, raises the question about whether agency judges have been given the sort of judicial authority that belongs with Article III judges alone. Even this sort of a claim is not convincing, but it benefits from the fact that ALJ process has frequently been found to be interchangeable, in quality, with that offered by the district courts. For a further discussion see *infra* Part II.C.3.

174. This is so-called *Chevron* deference, a doctrine that requires courts to defer to agency's

initiating more administrative proceedings is a reasonable interpretation of the amendments to Dodd-Frank authorizing it to do so, there is little question that the SEC is reasonably interpreting congressional direction.

This doctrinal part of the Article reviews the arguments against filing cases before ALJs made by defendants in the wake of the SEC's new enthusiasm for administrative adjudication, and explains how they are wanting. Part III argues that the disjunction between the deeply held beliefs of the corporate bar, and the realities of current administrative law doctrine can tell us something interesting about what corporate lawyers expect from the courts – namely, equity. That is something that fits only roughly with the procedural orientation of administrative proceedings at the SEC.

A. *Removal*

The most successful claim made against the SEC's ALJs is the most novel one, and is based on the Supreme Court's comparatively recent separation of powers case, *Free Enterprise Fund v. PCAOB*,<sup>175</sup> which cast doubt over agencies that enjoyed multiple layers of protection against at will termination by the president.<sup>176</sup> The claim proves far too much, however—

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permissible construction of the authority-granting statute. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844–845 (1984).

175. [FA]

176. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 586 (2010).

2016]

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163

taken seriously it would undo the institution of formal adjudication in administrative law, an institution that has been upheld by the Supreme Court either explicitly or implicitly, dozens of times.

The President's responsibility to take care that the laws be faithfully executed, among other things, means that he is entitled to some ability to remove some executive officers to ensure that they are responsive to his interests.<sup>177</sup> The power to remove has also been inferred from, and shaped by, the power to appoint certain executive officers, which must be vested in the president.<sup>178</sup> What this means in practice is that there must be some senior

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177. *Id.* at 483. "In light of the impossibility that one man should be able to perform all the great business of the State, the Constitution provides for executive officers to assist the supreme Magistrate in discharging the duties of his trust. Since 1789, the Constitution has been understood to empower the President to keep these officers accountable—by removing them from office, if necessary").

178. The sort of protections an officer may have is related to the constraints imposed by the Appointments Clause, which restricts the constraints that Congress may impose upon the authority of the President to choose his preferred candidates for important executive branch posts. Under Article II of the Constitution, "The President . . . shall appoint ambassadors, other public ministers and consuls, judges of the Supreme Court, and all other officers of the United States." U.S. CONST. Art. 2 § 2. The appointment of so-called inferior officers need not be subject to Senate confirmation, but the power to appoint them must be vested in "the President, the Heads of Departments, or the Courts of Law." *Id.* It is these officers whose job security requires constitutional limitations, lest the president lose control over his executive branch. Many bemoaned that it has never been made clear by the Supreme Court what, exactly, makes a government official a principal officer of the United States needing Senate confirmation, or an inferior officer or mere employee, who does not.

officers that may be removed at will by the President, and other, less important, senior officers, that can enjoy “for cause” protections against termination, but for cause protections of limited scope.<sup>179</sup>

ALJs enjoy a great deal of job security—something that poses no constitutional problem for unimportant federal officials, such as, say prison guards or prosecutors, all of whom enjoy typical civil service job protections—but that matters for the sorts of federal official in a position to make, or frustrate, policy in the way the president would like.<sup>180</sup> Kevin Stack has observed that at least “some ALJs . . . possess more than purely recommendatory functions” about the disposition of cases, which, if true in the SEC, might seem to make the officials important enough in the scheme

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*See, e.g.,* Landry v. F.D.I.C., 204 F.3d 1125, 1132 (D.C. Cir. 2000) (“The line between mere employees and inferior officers is anything but bright.”); Harold J. Krent, Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government, 85 Nw. U. L. Rev. 62, 112 (1990) (“The reach of the appointments clause, however, is unclear”). But the majority in *Morrison v. Olson* announced a “core functions” test that involves, in the words of dissenting Justice Antonin Scalia, “taking all things into account.” *Morrison v. Olson*, 487 U.S. 654, 733, (1988) (Scalia, J., dissenting).

179. “For cause” protection means that that the officer could be terminated only because she is not doing her job well, not that she is doing her job in a way inconsistent with the policies of the President. For a discussion of the differences between for cause and at will employment, see Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 969 (1984).

180. [FA]



2016]

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165

of enforcement powers to warrant presidential supervision.<sup>181</sup>

However, supervision is not something that the president can easily provide through the disciplining ability to fire the adjudicator; Justice Breyer has observed that ALJs are “subject, by statute, to two layers of for-cause removal,” which makes their relationship to the president insulated.<sup>182</sup> In fact, Justice Breyer understated the case. They can only be removed from their posts for cause,<sup>183</sup> and then only if the SEC, whose commissioners can only be removed from their posts for cause, bring a proceeding against the ALJ before the Merit Services Protection Board, an independent federal agency that also is comprised of members who may only be removed for cause.<sup>184</sup> Taken seriously, this triple layer of for cause protection means that the President has very little ability to enact his preferred security regulation policy by removing those inferior officers who hear cases brought by the SEC.

The removal concerns have been given a boost by the logic of *Free Enterprise Fund v. PCAOB*, where the Court held that “multilevel protection

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181. Kevin M. Stack, *Agency Independence After PCAOB*, 32 CARDOZO L. REV. 2391, 2419 (2011).

182. *Free Enter. Fund*, 561 U.S. at 586.

183. 5 U.S.C. § 7521(a).

184. They are removable by the President “only for inefficiency, neglect of duty, or malfeasance in office.” 5 U.S.C. § 1202(d).

from removal is contrary to Article II's vesting of the executive power in the President."<sup>185</sup> The case arose out of disciplinary proceedings brought against an accounting firm by the Public Control Accounting Oversight Board, an institution within the SEC created in the Sarbanes-Oxley Act, after a number of high profile firms admitted to enormous misstatements in their annual reports in the wake of the collapse of the dotcom bubble at the turn of the century.<sup>186</sup> The board was supposed to ensure that accounting firms were subject to professional and ethical standards that would make it unlikely that they would miss or be implicit in these sorts of misstatements in the future; its budget came largely from fees paid by the accounting industry, and its members, critically, enjoyed for cause protection.<sup>187</sup>

The case posited that the control of the President over executive action is imperiled if the President cannot reach inferior officers of officers of the United States protected by too much for cause protection.<sup>188</sup> "The President cannot 'take Care that the Laws be faithfully executed' if he cannot oversee the faithfulness of the officers who execute them," said Chief Justice John Roberts for the majority."<sup>189</sup>

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185. *Free Enter. Fund*, 561 U.S. at 484.

186. [FA]

187. [FA]

188. *Id.*

189. *Id.*

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167

In *Free Enterprise Fund*, it was members of the PCAOB who could only be removed for cause by the commissioners of the SEC who, in turn (it was agreed) could only be removed for cause.<sup>190</sup>

Indeed, it is only through the *Free Enterprise Fund* case that the problem of bringing cases before ALJs becomes problematic. After all, the ALJs have existed for years, and the hearing examiners who proceeded them were among the first instantiations of the federal bureaucracy, which was originally created more in the image of courts adjudicating cases, rather than in the image of rule makers writing prospective regulations.<sup>191</sup>

Claims arguing that this structure, in light of *Free Enterprise Fund*, unconstitutionally burdens the president's removal powers have been brought by most of the defendants whose cases have been routed to administrative proceedings, and have persuaded a handful of judges.<sup>192</sup> The problem with these cases is that they, if taken seriously, would undo most of the work of administrative law judges, not just for the SEC, but also for other agencies, as well.

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190. Amazingly, this for cause protection does not appear in the SEC's governing statute, but was stipulated by the parties to the case. *Id.* at 487, 130 S. Ct. 3138 ("The parties agree that the Commissioners cannot themselves be removed by the President except [for] inefficiency, neglect of duty, or malfeasance in office . . . , and we decide the case with that understanding.").

191. *See supra* note 38 and accompanying text.

192. *See supra* notes 16–17, and accompanying text for a review of some of these cases.

Nor is the SEC the only agency that would be affected if the claim was taken seriously.<sup>193</sup> The Social Security Administration, which is the largest employer of ALJs in the government, depends upon them to process disability claims.<sup>194</sup> The International Trade Commission has given the responsibility to make initial decisions on whether imports that violate intellectual property protections should be banned—yes, banned—from sale in the United States—a power to which American companies have resorted liberally.<sup>195</sup>

It is more likely that cases that waffled on establishing hearing officers as inferior officers of the United States would be revisited to avoid such a

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193. Bob Van Vorts & Matt Robinson, *For The SEC, A Questing of Justice for All*, BLOOMBERG BUSINESS, Aug. 10, 2015, <http://www.bloomberg.com/news/articles/2015-08-10/for-the-sec-s-in-house-court-a-question-of-justice-for-all> [<https://perma.cc/EKF5-67JR>] (“The five SEC judges are part of a much larger pool of almost 1,700 administrative judges working in 26 federal departments and agencies.”).

194. As Jeff Lubbers has explained, “most agencies to hire existing ALJs laterally from other agencies, most often ““cherry-picking” from SSA, which employs approximately 85% of the overall ALJ corps.” Jeffrey S. Lubbers, *Should Congress Create A Special Category of SSA ALJs?* ADMIN. & REG. L. NEWS, Winter 2013, at 5, 6.

195. For a comprehensive overview of how adjudication before the ALJs in the ITC works, see Robert W. Hahn & Hal J. Singer, *Assessing Bias in Patent Infringement Cases: A Review of International Trade Commission Decisions*, 21 HARV. J.L. & TECH. 457, 462 (2008) (noting that “[t]he remedies available to the ITC are injunctive in nature” including “exclusion orders banning the importation of infringing products.”).

2016]

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169

result.<sup>196</sup> If the ALJs are not deemed to be inferior officers, but rather civil service employees, then there is no removal power problem posed by their triple-protected tenure.<sup>197</sup>

Conversely, the *Free Enterprise Fund* precedent could be interpreted to be limited to cases where the agency officials are engaged in non-adjudicatory activities, or only to apply to, as Rick Pildes has suggested, “Russian doll” type agencies, like the PCAOB uncomfortably located inside the SEC.<sup>198</sup>

Claiming the importance of affecting the course of adjudications for enacting the policies of the president is a strange line to draw; we usually hope that our adjudicators will not be susceptible to the influence of parties

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196. *Crowell v. Benson*, 285 U.S. 22, 54-63 (1932). *Crowell's* holding is difficult to distill into a footnote sized quote; here is one gloss on it: “In *Crowell*, Chief Justice Hughes distinguished between administrative adjudication of issues arising under the federal statute, which was approved, and adjudication of constitutional questions concerning Congress’s jurisdiction, which was reserved for the courts.” John Harrison, *The Relation Between Limitations on and Requirements of Article III Adjudication*, 95 CAL. L. REV. 1367, 1379 (2007).

197. Civil service protections are acceptable for the vast majority of Federal employees and those, as a matter of course, include protections against removal for anything other than cause. *Buckley v. Valeo*, 424 U.S. 1, 126 n.162 (1976) (per curiam).

198. Richard H. Pildes, *Separation of Powers, Independent Agencies, and Financial Regulation: The Case of the Sarbanes-Oxley Act*, 5 N.Y.U. J. L. & BUS. 485, 487 (2009) (describing the argument as one positing that “a Russian-doll approach to independent agencies must exceed the limits of what the Constitution permits”).

outside of their tribunals.<sup>199</sup> ALJs, it is supposed, were created to deliver judicially comparable trial-type justice.<sup>200</sup> That quality would be compromised if those judges were not independent or impartial, but subject to the influence of the President because of the power he could wield over their continued employment. But that is what a holding that the *Free Enterprise Fund* logic applied would require.

*B. Equal Protection*

The equal protection claims made by prospective defendants against the SEC's new ALJ practice are rooted in a sense that those defendants who are prosecuted administratively are being treated unconstitutionally differently than those defendants who are sued by the agency in civil Federal court. This doctrinal vehicle for the claim is the Equal Protection Clause, which has requires the federal government to ensure that no person within its jurisdiction is denied "the equal protection of the laws."<sup>201</sup> The legal theory is that the selective filing of cases before ALJs when similarly situated defendants enjoy the benefits of judicial jurisdiction, as well as rules of

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199. [FA]

200. *See infra* notes 221–223 and accompanying text (describing the precedent analogizing ALJ proceedings and district court proceedings).

201. U.S. CONST. AMEND. XIV.

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171

evidence and procedure.<sup>202</sup>

Ordinarily the Equal Protection clause is triggered by claims of discrimination by the government on the basis of race or gender.<sup>203</sup> Aggrieved targets of SEC enforcement have not levied such changes, however—they are arguing that the unfair discrimination lies in the selection of their case for administrative proceedings, while comparable cases go to court.<sup>204</sup>

Such claims are not unprecedented. “Successful equal protection claims [may be] brought by a ‘class of one,’ where the plaintiff alleges that she has been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment,” the Supreme Court has explained.<sup>205</sup>

However, the standard for making a constitutional claim for what essentially amounts to a selective prosecution argument is a high one.<sup>206</sup> A selective prosecution argument requires the defendant to prove not just a disparate impact but also intent on the part of the government to prosecute

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202. *United States v. Armstrong*, 517 U.S. 456 (1996) (setting forth the test for establishing selective prosecution).

203. [FA]

204. [FA]

205. *Village of Willowbrook v. Olech*, 528 U.S. 562, 564–66 (2000).

206. *Cf. Armstrong*, 517 U.S. at 468-69.

“because of” defendant’s membership in an identifiable group.<sup>207</sup> Agencies make decisions to route cases in house or towards courts frequently (indeed, the SEC implicitly does so in every case), and have done so for many years. Agencies almost never lose lawsuits on selective prosecution grounds.<sup>208</sup>

Nonetheless, the equal protection theory has won one battle; Judge Rakoff found that in a case where one member of a conspiracy faced charges that were to be brought before an ALJ, while the other 27 members of the conspiracy had been sued by the SEC in Federal court, had a plausible argument that he consisted of a so-called class of one that was being treated arbitrarily differently from his co-defendants.<sup>209</sup> The court held that the respondent’s allegations that he had been “intentionally, irrationally, and illegally” treated differently from his co-defendants was sufficient to allow review of the SEC’s choice to bring administrative proceedings prior to an ALJ initial decision.<sup>210</sup>

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207. *Wayte v. U.S.*, 470 U.S. 598, 610 (1985). The SEC is entitled to the same standard of review when acting in its prosecutorial capacity as the Department of Justice. *See Fog Cutter Capital Group Inc. v. SEC*, 474 F.3d 822, 827-27 (D.C. Cir. 2007).

208. *See Max Minzner, Should Agencies Enforce?* 99 MINN. L. REV. 2113, 2168 (2015) (“consider claims of selective prosecution. As a general matter, federal prosecutions are virtually immune to these arguments. . . Courts of Appeals have applied a principle of equal deference to administrative enforcement actions.”).

209. *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 513 (S.D.N.Y. 2011).

210. *Id.* Other District Courts who have considered this issue have rejected review prior to a



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173

But such a case is quite an outlier, and the language in the case would have permitted the court to have reversed itself upon factfinding (it suggested that an equal protection claim might apply in the context of a motion to dismissing, assuming all the facts alleged by the plaintiff were true).<sup>211</sup> It is very unlikely that other federal judges will follow in Judge Rakoff's wake.<sup>212</sup>

*C. Due Process*

There are three aspects to the due process claims that have been levied against the SEC's ALJ program. One such claim argues that the routing cases that could have been brought in court—and would have been before passage of the Dodd-Frank Act—to ALJs is constitutionally problematic, because it

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final agency decision. *See Jarkey v. SEC*, 48 F. Supp. 3d 32, 40 (D.D.C. 2014) (holding that review of equal protection claim would only be available on appeal of agency decision); *Chau v. SEC*, 2014 WL 6984236 at \*6 (S.D.N.Y. Dec. 11, 2014) (holding that review of equal protection claim would be still be available after administrative final decision and distinguishing *Gupta* on its facts as respondent lacked evidence of other similarly situated defendants who were treated differently).

211. *See Gupta*, 796 F. Supp. 2d at 514 (noting that a stay in the administrative proceedings had the effect of “providing this Court with ample opportunity to resolve this injunctive action on the merits.”).

212. As another district court has observed, “*Gupta* is questionable in the wake of *Altman v. SEC*, 687 F.3d 44, 45 (2d Cir.2012), which . . . affirm[ed] a District Court’s decision that it did not have subject matter jurisdiction over a constitutional challenge to an ongoing SEC administrative proceeding.” *Jarkey v. United States Sec. & Exch. Comm’n*, 48 F. Supp. 3d 32, 40 n.2 (D.D.C. 2014).

is unfair to those defendants who could have enjoyed a day in court.<sup>213</sup> A second argues that the ALJ program, where agency officials act as judge, jury, and prosecutor, violates the due process rights of defendants.<sup>214</sup> And a third posits that the lack of consent by some defendants to submit themselves to ALJ jurisdiction—they are unlike the usual licensed ALJ defendant—makes it unfair to subject them to any proceeding other than that before a federal court.<sup>215</sup>

None of these arguments are very availing—the Supreme Court has praised the process offered by ALJs in the past, and agencies have been expressly permitted to combine the functions of enforcement and adjudication under one roof.<sup>216</sup> Other agencies have often filed suit against unlicensed defendants, and have never been deemed to be violating due process in doing so. Nonetheless, all have their superficial appeal and their adherents.

*1. Fairness.*—The concern with fairness is exemplified by the collateral proceedings initiated by a Houston hedge fund manager alleged to have steered oversized fees to a brokerage firm CEO. The hedge fund manager

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213. [FA] [AU10] These are all cited in the stuff below this would be Mathews, see *infra* the fairness section n217....

214. [FA] *withrow v. larkin* see *infra* the combinations of functions subsection

215. [FA see *infra* consent section

216. [FA] *withrow v. larkin*

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175

sued rather than be faced with an ALJ proceeding because such a proceeding lacks “minimum standards of fairness.”<sup>217</sup>

The test for the process given by an agency is a three factor balancing test announced in *Mathews v. Eldridge*.<sup>218</sup> The factors to be balanced are first, “the private interest that will be affected by the official action;” second, “the risk of an erroneous deprivation of such interests through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards”; and third, “the Government’s interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.”<sup>219</sup>

The private interest is substantial enough, and, although the SEC can point to efficiency reasons to have the choice of access to administrative proceedings, the real problem for defendants is establishing, given the precedent to the contrary, that additional or substitute procedural safeguards will make them better off.

Time and again ALJs have been held up as examples of due process. Indeed, many administrative law scholars think that formal adjudication is a rather inefficient system that plays an increasingly unimportant role in

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217. *Jarkesy v. SEC*, 48 F. Supp. 3d 32 (D.D.C. 2014).

218. 424 U.S. 319 (1976).

219. *Id.* at 335.

agency policymaking because it offers so much process to defendants at some cost to administrative efficiency and bureaucratic rationality.<sup>220</sup>

For its part, the Supreme Court has held that the similarities between adjudication before ALJs and before federal district court judges are “overwhelming”—and no one thinks that federal civil trial practice violates the requirements of due process.<sup>221</sup> The Court has also said that the role of ALJs when presiding over hearings as “functionally comparable” to that of an Article III judge.<sup>222</sup> The SEC’s own rules of practice are “similar to the Federal Rules of Civil Procedure,” resulting in hearings “virtually identical to U.S. district court bench trials.”<sup>223</sup> Scholars have agreed.<sup>224</sup>

The SEC has been offering the process provided by its ALJs since

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220. See *supra* note 20 and accompanying text.

221. Fed. Mar. Comm’n v. S.C. Ports Auth., 535 U.S. 743, 759 (2002).

222. *Butz*, 438 U.S. at 513.

223. Daniel F. Solomon, *Summary of Administrative Law Judge Responsibilities*, 31-2 J. NAT. ASSOC. ADMIN. L. JUDICIARY 475, 516 (2011).

224. See, e.g., Chris Guthrie et. al., *The “Hidden Judiciary”: An Empirical Examination of Executive Branch Justice*, 58 DUKE L.J. 1477, 1482-83 (2009) (“ALJs possess educational and professional credentials comparable to those of generalist judges, and in the courtroom, they perform the same function.”); R. Terrence Harders, *Striking a Balance: Administrative Law Judge Independence and Accountability*, J. NAT’L ASS’N ADMIN. L. JUDGES, Spring 1999, at 1, 9 (“[T]hose who come before ALJs recognize that the deciding of disputes, the prescribing of duties, and the recognition of entitlement affects them in much the same way that litigation plays out in courts of law.”).

2016]

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177

passage of the APA, and it has never been successfully accused of violating due process for doing so.<sup>225</sup> Indeed, the ALJs in the agency have been held up as a model of process. The GAO studied the agency's use of ALJs in the 1990s; rather than question the legitimacy of the process offered by them, the GAO suggested that some reforms undertaken by the office might serve as a model for comparable reforms that might be undertaken by comparable agencies.<sup>226</sup>

It is true that there might be some point at which consistently observed practice in enforcement could, if suddenly shifted, create issues of

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225. As the SEC's enforcement director recently observed, "we have been using administrative proceedings throughout the 42-year history of the Division of Enforcement, and the Commission used them even before its enforcement activities were consolidated in one division. SEC administrative law judges (ALJs) have adjudicated hundreds of enforcement matters over the years." *See* Ceresney, *supra* note 99 and accompanying text.

226. In particular, the GAO concluded that the SEC's structuring of its ALJ program might be duplicated by the comparable program run by the CFTC. GAO, *Administrative Law Judges: Comparison of SEC and CFTC Programs* (GAO/GGD-96-27 Nov. 1995). Congress and the Administrative Conference of the United States mulled over whether to increase the powers of the SEC's ALJs in the 1960s. Emmette S. Redford, *The President and the Regulatory Commissions*, 44 *Texas L. Rev.* 288, 316 (1965) (describing reform proposals mulled during 1961, for example: "Reorganization Plans 1 to 5 inclusive and 7 proposed that the SEC, FCC, CAB, FTC, NLRB, and FMC be authorized to delegate final disposition of cases to divisions of the commission or board, to individual members, to hearing examiners, or other employees, subject to review on the vote of one less than a majority of the commission or board.").

arbitrariness, but such a claim that could be brought under the APA itself rather than under the Constitution—and if anything, the Supreme Court has recently indicated its general acceptance of policy shifts made without formal notice.<sup>227</sup>

2. *Combination of Functions.*—The Wall Street Journal has weighed in against “The SEC as Prosecutor and Judge,”<sup>228</sup> and the corporate law scholar Stephen Bainbridge has asked wondered “[s]hould the SEC be prosecutor, judge, jury, and executioner?”<sup>229</sup> This sort of argument has been made about administrative adjudicators has a long pedigree, even if, as Bainbridge admits, it has never gone very far in the courts.<sup>230</sup> It is undoubtedly odd that,

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227. This year, the Court, in a reversal of the practice of the D.C. Circuit, reversed a requirement that agencies undergo notice and comment rulemaking if they sought to change policies that had originally been promulgated without substantive effect. *Perez v. Mortgage Bankers Ass’n*, 135 S. Ct. 1199, 1201 (2015) (holding that an agency need not “use the APA’s notice-and-comment procedures when it wishes to issue a new interpretation of a regulation that deviates significantly from one the agency has previously adopted”).

228. Russell G. Ryan, Op-Ed, *The SEC as Prosecutor and Judge*, WALL ST. J., <http://www.wsj.com/articles/russell-g-ryan-the-sec-as-prosecutor-and-judge-1407195362> [<https://perma.cc/43NY-XY4B>] (Aug. 4, 2014).

229. Stephen Bainbridge, *Should the SEC be Prosecutor, Judge, Jury, and Executioner?* PROFESSOR BAINBRIDGE, <http://www.professorbainbridge.com/professorbainbridgecom/2014/10/should-the-sec-be-prosecutor-judge-jury-and-executioner.html> [<https://perma.cc/E969-4CY2>] (Oct. 10, 2014).

230. *Id.* Indeed, the SEC has been criticized for this since its inception. “There is something

2016]

Zaring.A1Edit

179

as Daniel Walfish has observed, SEC commissioners hear appeals from administrative proceedings, “[a]nd yet the Commission is the same body that in the first place decided to prosecute the case.”<sup>231</sup>

The problem lies in *Withrow v. Larkin*,<sup>232</sup> in which the Supreme Court held that in an agency, “the combination of investigative and adjudicative functions does not, without more, constitute a due process violation.”<sup>233</sup> The mere fact that everyone involved in administrative proceedings works for the agency is not enough to imperil the constitutionality of the process followed, even if the agency does not carefully separate those functions on its organizational chart; *Withrow* means that there is no constitutional problem with the agency’s commissioners requiring that enforcement actions be approved by them, even if they know that they may have to sit on appeals of those enforcement actions, as is the case with most agencies with law enforcement powers (indeed, the facts of *Withrow* covered precisely this

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abhorrent in the idea that any single group may make laws, may act as a public prosecutors in enforcing those laws, and may then determine the guilt or innocence of the person it has accused.” Roland Redmond, *The Securities Exchange Act of 1934: An Experiment in Administrative Law*, 47 YALE L. J. 622, 636 (1938).

231. Daniel R. Walfish, *The Real Problem With SEC Administrative Proceedings, and How To Fix It*, FORBES, July 20, 2015, <http://www.forbes.com/sites/danielfisher/2015/07/20/the-real-problem-with-sec-administrative-proceedings-and-how-to-fix-it/> [https://perma.cc/8HWN-Q6N6].

232. [FA]

233. *Withrow v. Larkin*, 421 U.S. 35, 58 (1975).

issue, with the members of a state board reviewing proceedings brought against a doctor in a case that the board initiated).<sup>234</sup>

But the reasons to be comfortable with a combination of functions in one agency is especially strong in the case of formal adjudications, because ALJs have a great deal of statutorily protected independence. By law, they cannot, when holding hearings, be supervised by in-house prosecutors, for example, and they enjoy a host of job protections that limit the ability of the agency to monitor their efficiency, let alone interfere with their decisionmaking.<sup>235</sup>

The Supreme Court has already held that the fact that proceedings inside an agency were brought before an administrative law judge suggests that the requirements of due process were satisfied rather than violated.<sup>236</sup> Complaining that the odd fact that the SEC brings cases that it then reviews

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234. [FA]

235. 5 U.S.C. § 554. *See also* SEC Rules of Practice, Rule 121, 17 C.F.R. § 201.121 (“Any Commission officer, employee, or agent engaged in the performance of investigative or prosecutorial functions for the Commission in a proceeding . . . may not, in that proceeding or one that is factually related, participate or advise in the decision. . . .”).

236. *See, e.g.,* *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 248 (1980) (civil penalty system permitting payment of fines assessed by administrative law judge to federal agency did not violate due process because it was “the administrative law judge, not the [Employment Standards Administration], who performs the function of adjudicating child labor violations”).



2016]

Zaring.A1Edit

181

on appeal rises to claim of legality goes against settled precedent.<sup>237</sup>

3. *Consent.*—These due process arguments might be understood to be rooted in a concern by the lack of consent offered by the post-Dodd-Frank defendants who are newly susceptible to administrative proceedings. It is one thing to seek a license to practice before an agency; in such a case discipline through internal agency procedures might seem like a part of the arrangement. Practitioners receive the benefit of the ability to practice before the agency, it is only reasonable that they accept the burden of being subjected to the agency's rules, and as a secondary matter, subject to agency investigations into compliance with those rules, done through procedures prescribed by the agency itself, provided they meet the minimum constitutional standards.

Lawyers who wanted to turn the issue into a litigatable one might make an analogy to the Supreme Court's jurisprudence on bankruptcy court judges.

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237. Walfish has argued, to be sure, that “[a]lthough Congress and the Supreme Court have technically given the governing body at the top of an agency the ability to serve a dual role in authorizing charges and adjudicating them, the SEC Commissioners appear not to be actually using this authority in the way that Congress and the Supreme Court expected when they conferred it.” See Walfish, *supra* note 231. But even a close investment in the decision to prosecute and the ultimate review seems to pass constitutional muster, and, of course, the ALJs are insulated from agency influence; reversing them is the sort of thing that would get the attention of federal judges on review, too. Giving the enforcement division the power to bring cases without a commission sign-off, as Walfish recommends, might be good policy, but is unlikely to be legally required.

The Supreme Court established in the seminal *Northern Pipeline*<sup>238</sup> case that there is a limit to the powers that can be conferred on an Article I court.<sup>239</sup> The Court held that Congress could not grant upon an Article I court “the essential attributes of judicial power.”<sup>240</sup> While the “essential attributes” were not explicitly defined, the Court held in *Northern Pipeline* that bankruptcy judges lacked the authority to hear state law counterclaims based on contract and misrepresentation.<sup>241</sup>

The court fleshed out this holding in *Stern v. Marshall*,<sup>242</sup> where the court held that “when a suit is made of the stuff of the traditional actions at common law tried by the courts at Westminster in 1789 and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suits rests with Article III judges in Article III courts.”<sup>243</sup> In *Stern*, the Court reiterated that bankruptcy judges, regardless of statutory authorization from Congress, lacked the authority to decide common law counterclaims.<sup>244</sup> While the bankruptcy courts only issued preliminary opinions, the court held

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238. [FA]

239. *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 76 (1982).

240. *Id.* at 80.

241. *Id.*

242. [FA]

243. *Stern v. Marshall*, 131 S. Ct. 2594, 2609 (2011).

244. *Id.* at 2610.

2016]

Zaring.A1Edit

183

that because district courts gave substantial deference to the bankruptcy courts' findings of fact, the bankruptcy courts could not be considered adjuncts of Article III courts.<sup>245</sup>

At first blush, these bankruptcy holdings seem to have little to do with the SEC's use of ALJs. Unlike the bankruptcy cases, the SEC administrative proceedings do not involve common law counterclaims, but instead involve purely statutory violations.<sup>246</sup> A civil penalty for violation of the securities acts is not "a suit made of the stuff . . . tried by the courts at Westminster in 1789."<sup>247</sup> Moreover, the securities laws are an area where the SEC has special expertise.<sup>248</sup>

And in practice, many other agencies use ALJs to adjudicate claims that would otherwise come within the jurisdiction of the federal courts. For example, the International Trade Commission uses ALJs to adjudicate allegations of "unfair trade practices"—a term set forth in a statute, but one with common law origins.<sup>249</sup> ITC ALJs have the power to issue exclusion

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245. *Id.* at 2611.

246. [FA]

247. [FA]

248. *Cf.* *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 865 (1984) ("[A]n agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments.").

249. 19 U.S.C. § 1337(b).

orders that ban products that infringe US patents from being imported into the US.<sup>250</sup> This sweeping power results in in rem orders that are directed at the infringing products and binding on all parties, including parties outside the US who are not even aware of the ITC proceeding—in rem remedies also have common law analogies.<sup>251</sup>

The Federal Trade Commission uses ALJs oversee hearings and issue initial decisions in unfair trade practices cases.<sup>252</sup> Similar to the SEC context, FTC ALJs have sweeping authority to issue injunctive relief against any person “using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce.”<sup>253</sup> The FTC has the power only to order injunctive relief and not money penalties, but these FTC cases can sweep in anyone who violates the antitrust laws, not just regulated entities or those who consent to the agency’s jurisdiction.

The Environmental Protection Agency ALJs issue initial decisions to

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250. 19 U.S.C. § 1337(d).

251. See, e.g., Gary M. Hnath, *General Exclusion Orders Under Section 337*, 25 NW. J. INT’L L. & BUS 349, 351 (2004).

252. 15 U.S.C. § 45(b).

253. *Id.* And like the SEC, the FTC has been accused of being an impossible venue for respondents. See, e.g., David Balto, *Can the FTC Be A Fair Umpire?*, THE HILL.COM CONGRESS BLOG Aug. 14, 2013, <http://thehill.com/blogs/congress-blog/economy-a-budget/316889-can-the-ftc-be-a-fair-umpire> [<https://perma.cc/DD6C-YLH5>] (noting that from 1995 to 2013, the FTC won every case it brought in the administrative forum).

2016]

Zaring.A1Edit

185

decide alleged violations of a variety of environmental protection statutes.<sup>254</sup> Under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), for example, EPA ALJs may impose penalties of up to \$25,000 per day for failure to comply with EPA orders.<sup>255</sup> These penalties may be imposed regardless of any prior consent to EPA jurisdiction.<sup>256</sup>

But the SEC's use of ALJs might be—and this is the best doctrinal case against the agency's authority—different in some ways. It requires analogizing the heavy fines and penalties, and the frequent follow-on nature of the penalties to something that looks close enough to being part of a criminal case to raise constitutional questions.

It is clear that the Supreme Court's jurisprudence in cases like *Northern Pipeline* would prevent an administrative agency from hearing criminal cases.<sup>257</sup> The SEC itself does not itself prosecute criminal violations of the securities laws in federal court, relying instead on the Department of Justice and U.S. Attorney's offices, though SEC staff may assist on criminal cases.<sup>258</sup>

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254. See 40 C.F.R. § 22.1 (listing statutes under which EPA ALJs have authority to issue civil penalties).

255. 42 U.S.C. § 9609.

256. [FA]

257. See *supra* note 35 and accompanying text.

258. See Linda Chatman Thomsen, *An Overview of Enforcement*,

But the SEC follows the criminal proceedings, often closely, with administrative proceedings that are entirely a fait accompli, where the only question is what sort of civil punishment will be imposed.<sup>259</sup> Moreover, the SEC under its current leadership has embraced bringing civil penalty actions in cases that also involve criminal prosecutions.<sup>260</sup>

Of those penalties, disgorgement has particularly broad and sweeping scope. Indeed, while the SEC is statutorily authorized to impose disgorgement,<sup>261</sup> disgorgement is not defined in the statute, and therefore is assumed to be contiguous with the equitable remedy previously imposed by Article III courts.<sup>262</sup> Unlike the statutorily defined penalties, which are fixed in amount and clearly defined,<sup>263</sup> disgorgement need only “reasonably

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[https://www.sec.gov/about/offices/oia/oia\\_enforce/overviewenfor.pdf](https://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf) [<https://perma.cc/2RNW-ZBXA>] (2005).

259. [FA]

260. See SEC Chair Mary Jo White, “All Encompassing Enforcement: The Robust Use of Civil and Criminal Actions to Police the Markets,” <http://www.sec.gov/News/Speech/Detail/Speech/1370541342996> [<https://perma.cc/93YQ-SEMQ>], Mar. 31, 2014.

261. 15 U.S.C. § 77h-1(e).

262. The SEC does not have statutory authority to seek disgorgement in federal court. Instead, it has asserted and courts have held that it has this authority as an equitable extension of its broader authority to enforce the securities laws. See, e.g., SEC v. First City Financial Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989).

263. See 15 U.S.C. § 77h-1(g)(2).

2016]

Zaring.A1Edit

187

approximate” the violator’s wrongful gain.<sup>264</sup>

That is a very strong, almost judge-like power to impose punitive sanctions on defendants who never signed up for this policing by registering with the SEC. The lack of consent and seriously punitive, criminal related role, might, in some follow-on cases involve disgorgement and unregistered defendants, combine to look like something constitutionally troubling.

Even this sort of a claim would be fraught with problems. The Supreme Court has made it clear that follow-on civil proceedings for the same conduct that also gives rise to criminal proceedings does not pose an issue of double jeopardy.<sup>265</sup> In that same case, the Supreme Court affirmed the ability of an administrative agency, the Office of the Comptroller of the Currency, to impose civil penalties and injunctive relief against the respondents, who were later indicted in federal court on criminal charges.<sup>266</sup>

In some, despite some sympathy surrounding the degree of consent, and the way that Dodd-Frank has neatly replaced adjudication in federal court with an unfettered ALJ option, it is unlikely that even a consent-based theory of a due process violation, with a bit of separation of powers concerns thrown in, would be something sustainable for any defendants—and it certainly

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264. S.E.C. v. First Jersey Securities, Inc., 101 F.3d 1450, 1474 (2d Cir. 1996).

265. Hudson v. U.S., 522 U.S. 93, 101-02 (1997).

266. *Id.* at 96-97.

could not work for many of them.

*D. Right To A Jury*

The Seventh Amendment provides that “[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved.”<sup>267</sup> But proceedings before ALJs do not feature a jury; some defendants have argued that their jury trial right has accordingly been violated.<sup>268</sup>

The problem with the jury trial argument is that it only applies to “Suits at common law,” and the SEC’s administrative proceedings, designed to protect investors in kinds of markets that did not exist at the time of the framing of the Constitution, are not those kinds of suits.<sup>269</sup> As the Supreme Court said in *Atlas Roofing, Inc. v. OSHA*,<sup>270</sup> “when Congress creates new

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267. U.S. Const. Amend. VII.

268. See, e.g., Phyllis L. Skupien, *Former CEO Says SEC Administrative Proceedings Are Unconstitutional*, 20 Westlaw Journal Securities Litigation & Regulation 4 (2015) (“The former CEO of an assisted living company has sued the Securities and Exchange Commission in federal court, alleging the agency’s administrative proceedings against her deny her right to a jury trial and other constitutional protections. *Bebo v. Securities and Exchange Commission*, No. 15-00003, complaint filed (E.D. Wis. Jan. 2, 2015).”).

269. See *Hill v. S.E.C.*, No. 1:15-CV-1801-LMM, 2015 WL 4307088, at \*13 (N.D. Ga. June 8, 2015) (holding that the 7<sup>th</sup> Amendment jury trial right do not apply to SEC administrative proceedings).

270. [FA]



2016]

Zaring.A1Edit

189

statutory ‘public rights,’ it may assign their adjudication to an administrative agency with which a jury trial would be incompatible, without violating the Seventh Amendment’s injunction that jury trial is to be ‘preserved’ in ‘suits at common law.’”<sup>271</sup> It could hardly, of course, be otherwise, lest every tax dispute, EPA fine, or national park camping permit fight require the making of a federal case.<sup>272</sup> *Atlas Roofing* involved a civil penalty; the SEC’s civil penalty regime is similar, and so should pass constitutional muster.<sup>273</sup> The other remedies offered by the agency—cease and desist orders, industry bans, and likely also disgorgement, though that is a modestly closer call—present even more straightforward claims, because they look more like equitable remedies than the sorts of damages remedies that look like common law relief.<sup>274</sup>

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271. *Atlas Roofing Co. v. Occupational Safety & Health Review Comm’n*, 430 U.S. 442, 455 (1977).

272. As the Court observed. *Id.* at 450 (mentioning tax, immigration, and a District of Columbia rent control board). *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 48-49 (1937) (rejecting jury trial claim under National Labor Relations Act); *Wickwire v. Reinecke*, 275 U.S. 101, 105-06 (1927) (same for Internal Revenue Service).

273. *Atlas Roofing Co. v. Occupational Safety & Health Review Comm’n*, 430 U.S. 442, 461 (1977); *see also* 2 Fed. Proc., L. Ed. § 2:11 (“The right to a jury trial in suits at common law preserved by the Seventh Amendment is inapplicable in administrative proceedings.”).

274. The Supreme Court has occasionally suggested that such an analysis might limit the ability of agencies to take on any sort of justiciable claim. “To determine whether a statutory action is more similar to cases that were tried in courts of law than to suits tried in courts of equity or

*E. The SEC's Discretion To File Suit Where It Suits*

Any challenge to the SEC's decision to route cases to its internal adjudicators will have to grapple with the doctrines in administrative law that leave discretion to every agency as to how it deploys its enforcement powers. Agencies cannot be reversed for failing to prosecute someone who they could have prosecuted, and they have absolute discretion to make policy by rule, by lawsuit, or through internal adjudications. Those aggrieved by the SEC's policy to route more cases to its ALJs thus must argue that despite these principles, there is something arbitrary in bringing an enforcement action that could have been brought in court administratively. There is plenty of precedent that suggests that this is not a matter over which courts are willing to police agencies.<sup>275</sup>

The first of these doctrines holds that agencies, as a general matter discretion to choose between various enforcement mechanisms provided by Congress.<sup>276</sup> Accordingly, the SEC may choose to pursue civil remedies in

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admiralty . . . we examine the remedy sought and determine whether it is legal or equitable in nature." *Tull v. United States*, 481 U.S. 412, 417-18 (1987).

275. [FA] [AU11] **This is also a heckler v. chaney issue – or you can just do a see infra to note 276 – the note below this one.**

276. *See Heckler v. Chaney*, 470 U.S. 821, 838 (1985) (holding agency "refusals to institute investigative or enforcement proceedings" are committed to agency discretion); *Moog Indus. V. F.T.C.*, 355 U.S. 413-14 (1958) (per curia) (holding FTC's decision to proceed against some but not all members of an alleged cartel was committed to agency discretion).

2016]

Zaring.A1Edit

191

addition to criminal remedies pursued by the Department of Justice—the fact that a criminal case has been filed does not mean that the agency cannot bring follow-on proceedings to its ALJS.<sup>277</sup>

The second doctrine turns on the fact that Congress has provided the agency with the options that have so aggravated the defense bar; the securities laws give the agency the power to pursue an administrative cease and desist proceeding or a civil enforcement action in federal court.<sup>278</sup> But Congress has never suggested that the agency must choose one enforcement path or the other.<sup>279</sup>

Nor has the SEC constrained itself as to which forum it will pick, which might—although even this has not hampered many agencies from pursuing very different enforcement policies when new policymakers are appointed as commissioners—theoretically tie the hands of the agency (the argument would be that if the agency enforces exclusively in one way, even though it is not required to do so, the decision to enforce in another way would be arbitrary if it was unexplained).

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277. *See* SEC v. Dresser Indus. Inc., 628 F.2d 1368, 1377 (D.C. Cir. 1980).

278. *Compare* 15 U.S.C. § 78u-3 (authorizing cease and desist proceedings before ALJ) and 15 U.S.C. § 78u-1 (authorizing a civil action in district court).

279. *See, e.g.*, Senate Report on the Securities Law Enforcement Remedies Act of 1990, S. Rep. 101-337 at 17 (June 26, 1990) (describing the new cease-and-desist power as an “alternative” to district court litigation giving the SEC flexibility to choose between forums).

But the SEC has explained its approach. It has issued an “Approach to Forum Selection In Contested Actions,” in which it identified some factors it could consider in making the choice, including the availability of remedies, costs to the agencies, and “the effective resolution of securities laws issues”—but it has said that any listing of “potential relevant considerations . . . could not be[] exhaustive,” and would depend upon the agency’s discretion.<sup>280</sup>

One of the most famous cases of administrative law, *Chenery v. SEC*,<sup>281</sup> held that the agency was welcome to enact policy through ALJ adjudication, even though it could have done so through notice and comment rulemaking.<sup>282</sup> To require the agency to, once it has chosen to enact policy through ALJ adjudication, pursue those kinds of cases in federal court would call *Chenery* into question; it is an independent reason to be skeptical of the cases calling for courts to require that securities laws violations be brought before them.

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280. , SEC, *Division of Enforcement Approach to Forum Selection in Contested Actions*, [www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf](http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf) [<https://perma.cc/57WC-NVL7>] (2015).

281. [FA]

282. *SEC v. Chenery Corporation*, 332 U.S. 194 (1947) (“the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency”).

2016]

Zaring.A1Edit

193

*F. Timing Problems*

Finally, each of these constitutional claims must hurdle some difficult timing issues if they are raised in federal court—and because the plaintiffs are alleging an unconstitutional degree of unfairness in the fact that they have been kept out of court, it is federal court where these cases have been brought. That makes them collateral proceedings, raising questions of finality, exhaustion, ripeness, and judicial efficiency.<sup>283</sup> In any event, the challenges for obtaining immediate review in federal court have already resulted in dismissals of cases against the SEC’s policy on the basis that they were premature.<sup>284</sup>

Because the SEC has not completed its enforcement action before suit has been filed, judicial claims against the agency must first make the case that they need not wait until the agency action is final, ordinarily a constraint in administrative law.<sup>285</sup> Litigating over the propriety of unresolved agency claims also poses ripeness problems—in that the issues might not yet be “fit

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283. Or, the fact that the SEC has not issued a final disposition in the case could, as always, be cast as a problem of standing.

284. [FA] [AU12], <http://media.ca7.uscourts.gov/cgi-bin/rssExec.pl?Submit=Display&Path=Y2015/D08-24/C:15-1511:J:Hamilton:aut:T:fnOp:N:1609668:S:0>, duka from n.10.

285. *FTC v. Standard Oil Co. of California*, 449 U.S. 232, 243 (1980) (holding that the decision to launch an investigation was not “final agency action” suitable for judicial review).

for judicial resolution,” again, because the agency has more to do.<sup>286</sup> The idea is that a court should not hear constitutional issues, when they could be resolved in favor of the plaintiffs by the ALJ, making judicial involvement unnecessary.

By the same token, immediate judicial review raises exhaustion issues; plaintiffs aggrieved that the agency intends to, or is, suing them before agency ALJs have not given the agency, or the ALJs, the opportunity to evaluate their claims before they are being litigated in district court.<sup>287</sup> Exhaustion is not required unless specifically authorized by agency rule or governing statute; the Exchange Act provides that a “person aggrieved” by a final SEC order “may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of

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286. *Abbott Laboratories v. Gardner*, 387 U.S. 136, 149 (1967) (setting forth the ripeness test). Ripeness is assessed by determining balancing the fitness of the issues for resolution against the hardship to the plaintiff in withholding review. *Id.* That second factor, of course, might mitigate against a ripeness finding, but the first factor, given that the agency has not completed its enforcement actions in these cases, points in the other direction.

287. One possible reason not to require exhaustion is raised by the fact that one cannot raise counterclaims against the SEC before its administrative law judges. In the Matter of Jeffrey L. Feldman, Admin. Proc. File No. 3-8063, 1994 WL 23256, at \*2, 1994 SEC LEXIS 186, at \*4-5 (Jan. 14, 1994). But ALJs can of course entertain defenses, including affirmative defenses, and the claim that the process is unconstitutional would seem to be such a defense.

2016]

Zaring.A1Edit

195

business.”<sup>288</sup> The agency has characterized its remedial scheme as exclusive, meaning that it has argued that plaintiffs must avail themselves of appeal to the agency and then to the court of appeals.<sup>289</sup>

With the rise of standing, related decisions to eject plaintiffs from judicial fora, all of these problems, which are designed to promote judicial efficiency could be recast to question whether hearing the matter would run afoul of the Constitution’s “case or controversy” requirement. Federal judges may only hear cases in which the plaintiff has suffered a concrete injury attributable to the defendant, and the decision to institute enforcement proceedings, as opposed to imposing a sanction, against the petitioners might not be a sufficiently concrete harm.

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288. The courts have generally required litigants to exhaust their administrative remedies before proceeding to court to interrupt proceedings. “The administrative proceedings cannot be stopped to allow for excursions in the courts with prolonged evidentiary hearings; the time for that in a proper case is when an aggrieved litigant seeks judicial review of agency action having preserved the point of claimed disqualification in the administrative hearing.” SEC v. R. A. Holman & Co., F.2d 284, 287 (D.C.Cir. 1963).

289. 15 U.S.C. § 78y(a)(1). The Second Circuit has decided that this sort of provision for review “generally preclude *de novo* review in the district courts, requiring litigants to bring challenges ‘in the Court of Appeals or not at all.’” Altman v. S.E.C., 687 F.3d 44, 45-46 (2d Cir. 2012); *see also* Touche Ross & Co. v. S.E.C., 609 F.2d 570, 574-75 (2d Cir. 1979) (holding that claim that SEC tribunal was biased must first be presented in administrative forum rather than in collateral attack in district court).

These issues have stalled some of the first wave of plaintiffs.<sup>290</sup> But the Supreme Court's decision in *Free Enterprise Fund* has provided a potential loophole, at least in the eyes of some of the plaintiffs challenging the SEC's jurisdiction. In *Free Enterprise Fund*, the Court took up the plaintiff's appointments clause challenge to PCAOB without waiting for a final agency decision.<sup>291</sup> The Court held that there was no need for plaintiff in that case to incur a sanction from the agency before bringing a challenge to the constitutionality of PCAOB and that requiring the plaintiff to wait for "severe punishment" would leave them without a "meaningful avenue of relief."<sup>292</sup> Indeed, PCAOB had not even alleged a violation or sought a sanction, but had only begun an investigation.<sup>293</sup>

The rule applied in *Free Enterprise Fund* came from the Supreme

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290. As one judge has observed, district court jurisdiction "is not an escape hatch for litigants to delay or derail an administrative action when statutory channels of review are entirely adequate." *Chau v. SEC*, No. 14-cv-1903 (LAK), — F. Supp. 3d —, 2014 WL 6984236, at \*6 (S.D.N.Y. Dec. 11, 2014); *see also* *Bebo v. SEC*, <http://blogs.reuters.com/alison-frankel/files/2015/03/bebovsec-dismissalopinion.pdf> [<https://perma.cc/MHX2-4P92>] ("If the process is constitutionally defective, [plaintiff] can obtain relief before the Commission, if not the court of appeals").

291. *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 490-491 (2010).

292. *Id.* at 491 (citing *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212 (1994)).

293. *Id.* at 487.



2016]

Zaring.A1Edit

197

Court's 1994 case, *Thunder Basin Coal Co. v. Reich*.<sup>294</sup> In *Thunder Basin*, mine operators brought a pre-enforcement challenge against the Department of Labor alleging that the administrative procedure set out in the Mine Act of 1988 violated due process.<sup>295</sup> The court held that there was an exemption from the normal requirement of finality where the claim was 1) "wholly collateral" to the organic statute's review provisions and 2) outside the agency's expertise.<sup>296</sup> In addition, plaintiff 3) must make a colorable showing that there could be no meaningful judicial review if forced to wait for a final decision.<sup>297</sup>

The Court believed both of these requirements were satisfied in *Free Enterprise Fund*. The Court noted that the appointments clause challenge was outside the agency's expertise, instead posing only "standard questions of administrative law, which the courts are at no disadvantage in answering."<sup>298</sup> In addition, the court held that the plaintiffs could not obtain meaningful review without incurring "a sizeable fine."<sup>299</sup> This was enough for the Court

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294. [FA]

295. *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 206 (1994).

296. *Id.* at 212.

297. *Id.* at 213.

298. *Free Enterprise Fund*, 561 U.S. at 491.

299. *Id.*

to find review appropriate without waiting for a final agency decision.<sup>300</sup>

Some of the plaintiffs challenging the SEC's use of the administrative forum believe that this *Free Enterprise Fund* gives them a loophole to avoid waiting for a final decision.<sup>301</sup> This may be why many plaintiffs are choosing to base their challenges on the appointments clause.<sup>302</sup> Other challenges, such as due process or equal protection challenges, are a tougher sell for the *Thunder Basin* test.<sup>303</sup>

But these efforts to avoid the timing and injury problems posed by filing suit in district court over an agency process that has just begun are unconvincing. Article III courts rarely welcome challenges to agency action before the agency has done anything more than file an administrative complaint; it is difficult to see why *Free Enterprise Fund* should be interpreted to create a loophole in an otherwise consistent doctrine of judicial review.

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300. [FA]

301. *See, e.g.*, Complaint, Gray Financial Group v. S.E.C., No. 15-492 (M.D. Ga. Feb. 19, 2015), 26-27.

302. *Id.* But the strength of the argument that that ALJs violate the appointments clause is dubious. *See supra* Section II.A.

303. *See, e.g.*, Chau v. S.E.C., 2014 WL 6984236 at \*9 (Dec. 11, 2014) (rejecting attempt by plaintiff to fit pre-enforcement due process challenge into the *Free Enterprise Fund* framework).

2016]

Zaring.A1Edit

199

*G. Conclusion*

Despite the wide variety of arguments that have been made against the SEC's ALJ program, those arguments are, for the most part, arguments could be made against any sort of formal adjudication, which has been one of the pillars of the American administrative state. Indeed, the anxiety provoked in the corporate bar by the increasing use of ALJs is the sort of thing that immigration lawyers and disability advocates have bemoaned, unsuccessfully, for years.<sup>304</sup>

The right way to handle the claims against the SEC's enforcement policy is to treat it like any other question of administrative law, and judge it based—at most—on its reasonableness.<sup>305</sup> The question could be asked in the following way: is the decision to route more cases to in-house ALJs either committed to agency discretion is a choice of policymaking form, or a

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304. See Paul R. Verkuil, *Reflections Upon the Federal Administrative Judiciary*, 39 UCLA L. REV. 1341, 1362 (1992) (comparing the disability, immigration, and other ALJ contexts). Immigrants get adjudications that feature less process than formal adjudications under the APA. See Michele Benedetto, *Crisis on the Immigration Bench: An Ethical Perspective*, 28 J. NAT'L ASS'N ADMIN. L. JUDICIARY 471 (2008) (comparing immigration judges to ALJs); Stephen H. Legomsky, *Learning to Live with Unequal Justice: Asylum and the Limits to Consistency*, 60 STAN. L. REV. 413, 444-73 (2007) (discussing a variety of reforms designed to improve the system of administrative adjudication).

305. David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135, 140 (2010) (arguing that most standards of review in administrative law are based on a reasonableness calculation).

reasonable interpretation of congresses statutory command? Answering the question is straightforward enough. In either case, the SEC's approach would be affirmed.

Ordinarily, the agency enjoys unfettered discretion over whether to sue any potential defendant, courts do not review agencies for failing to prosecute anyone in particular.<sup>306</sup> Similarly, choices to proceed in policymaking through rulemaking, adjudication, or any other tool the agency has at its disposal, are not reviewed by the courts either.<sup>307</sup> That would seem to make the legal question one that is committed to agency discretion, as are choices as to whether to initiate enforcement actions and which administrative tool to use to make policy.

If the SEC's policy on when it might route cases to ALJs was itself subject to some sort of review, assuming it could somehow be characterized as agency action sufficiently definite as to be susceptible to judicial review,<sup>308</sup> the question would turn on whether the decision to entertain the use of ALJs more often was inconsistent with a reasonable interpretation of Dodd Frank's

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306. *See Heckler v. Chaney*, 470 U.S. 821, 838 (1985) (holding agency "refusals to institute investigative or enforcement proceedings" are committed to agency discretion).

307. *SEC v. Chenery Corp.*, 332 U.S. 194 (1947) ("the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency").

308. 5 U.S.C. § 553(a)(3) (providing that policy statements are not subject to judicial review).

2016]

Zaring.A1Edit

201

provisions expanding ALJ jurisdiction.<sup>309</sup> It would be straightforward to conclude that it is.

### III. Can ALJs Do Enough Equity To Make Their Processes Fair Ones?

This part of the Article argues that the disjunction between the deeply held beliefs of the corporate bar, and the realities of current administrative law doctrine, can tell us something interesting about what corporate lawyers expect from the courts—namely, equity. In an era when much corporate scholarship is concerned with the efficiency of various doctrines, and SEC rules, the preference of its litigators is worth remembering.

The alarm raised by the decision to divert cases to ALJs, when considered in the context of the straightforward legality of that choice, reflects a fundamental difference in the way that the corporate academics, and the corporate bar, sees the role of judges, when compared to the way administrative law works.

To corporate lawyers, judges, both in Delaware and on the federal courts, play an important moderating, equity-informed role that, if restrained, is above all designed to address excesses by both corporations and the agencies and plaintiff's lawyers who make managerial life difficult.

Delaware of course, *is* a court of equity, and few doubt the prominence

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309. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844–845 (1984) (setting forth the reasonableness test).

of its equitable nature in policing corporate law. Delaware Vice Chancellor John Noble has observed that “[i]t is a hallmark of Delaware corporate law that,” although the rules are few, “there are certain ‘best practices’ that the Court has identified as ways in which directors can demonstrate that they were adequately informed and acting reasonably in discharging their duties of care and loyalty.”<sup>310</sup> The fiduciary obligations of advisors and managers are the centerpiece of state corporate law, and Delaware has rigorously policed conflicts of interest.<sup>311</sup> Ed Rock, for example, has famously characterized the Delaware judges as sermonizers in an effort to establish what shareholder protection requires.<sup>312</sup> William Carney has suggested that “distinctive notions of equity” explain “the major differences in business entity law in the U.S.”<sup>313</sup>

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310. Frank v. Elgamal, No. CIV.A 6120-VCN, 2014 WL 957550, at \*20 (Del. Ch. Mar. 10, 2014) order enforced, (Del. Ch. Mar. 14, 2014).

311. See, e.g., In re Rural Metro Corp., 88 A.3d 54, 100 (Del. 2014) (faulting investment bank that “never disclosed to the Board its continued interest in buy-side financing and plans to engage in last minute lobbying”); in re Del Monte Foods Co. S’holders Litig., 25 A.3d 813 (Del. Ch. 2011) (conflict created when advising the sell side and offering financing to the buy side); In re El Paso Corp. S’holder Litig., 41 A.3d 432 (Del. Ch. 2012) (conflict created when investment bank had a personal stake in facilitating a merger, rather than in getting the best price for shareholders).

312. See Rock, *supra* note 23, at 169.

313. See William J. Carney, *The Background of Modern American Business Law*, at 2 (2015), reference at <http://www.bookforum.com/blog/14543> [<https://perma.cc/H4H7-XSUZ>].

2016]

Zaring.A1Edit

203

In addition, trial court judges in Manhattan have taken up this equitable role. The judges, often experienced with white-collar prosecutions, will occasionally discipline the government, not necessarily for violating the law but for going too far in a particular case.

For example, Judge Lewis Kaplan harshly criticized the government's efforts to prevent an accounting firm from paying the attorneys' fees of its employees as a transgression of the obligation to permit defendants to mount a defense.<sup>314</sup> Judge Jed Rakoff, who spent seven years as a federal prosecutor in Manhattan, culminating in a stint as the Chief of the Business and Securities Fraud Prosecutions Unit of the U.S Attorney's Office there, has played a similar role.<sup>315</sup> He started what became a nationwide campaign against "neither admit nor deny" settlements in the wake of the financial crisis,<sup>316</sup> and, as we have seen, scotched an SEC effort to route its insider

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314. "KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses. Those who commit crimes—regardless of whether they wear white or blue collars—must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend." *United States v. Stein*, 435 F. Supp. 2d 330, 336 (S.D.N.Y. 2006) *aff'd*, 541 F.3d 130 (2d Cir. 2008)

315. [FA]

316. "An allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect." *S.E.C. v. Citigroup Global Markets Inc.*, 827 F. Supp. 2d 328, 333 (S.D.N.Y. 2011) *vacated and remanded*, 752 F.3d 285 (2d Cir. 2014).

trading claims against Rajat Gupta towards the in-house administrative law judges.<sup>317</sup>

The Second Circuit arguably served a similar purpose in *United States v. Newman*,<sup>318</sup> which sharply, if somewhat incoherently, cut back on the kinds of insider trading cases that could be brought.<sup>319</sup> Newman added an arguably new requirement for insider trading prosecutions: those who trade based on inside information must know that the tipper who revealed the information did so not just in breach of a duty, but also in exchange for a benefit.<sup>320</sup> Put differently, downstream tippees *can* trade on material nonpublic information they know came from inside a company, as long as they do not know whether the insider revealed the information in exchange for a benefit. The rule disciplined a Manhattan U.S. Attorney's Office that had made a campaign against insider trading a centerpiece of its law enforcement efforts, using new tools, such as wiretaps, and aggressively phrased jury instructions in an effort to broaden the reach of the insider trading rules.<sup>321</sup> Those rules, famously

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317. See *supra* notes 209–212 for a discussion of the case.

318. [FA]

319. *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

320. *Id.* at 447 (“even in the presence of a tipper’s breach, a tippee is liable only if he knows or should have known of the breach”).

321. Joan Macleod Heminway, *Was Martha Stewart Targeted? MARTHA STEWART’S LEGAL TROUBLES 2-4* (JOAN MACLEOD HEMINWAY ED., 2007);



2016]

Zaring.A1Edit

205

undefined in any statute, were eventually interpreted by the Second Circuit to have been abusively interpreted by the federal prosecutors.<sup>322</sup>

Each of these cases were, in different ways, jurisprudentially challenging in their departure from custom; some were, or will be, reversed.<sup>323</sup> But they also played a role as part of a dialogue with government regulators. The message was that you've gone too far, and we're cutting back.

In the case of SEC ALJs, there have been complaints that “[t]he judges’ mind-set reflects the agenda of the agency, which in this arena is enforcement,”<sup>324</sup> that the work product of the adjudicators “ooze parochialism and tunnel vision, again showing the administrative forum is no place for enforcement actions of . . . magnitude,”<sup>325</sup> and that there is a “record

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322. *Newman*, 773 F.3d, at 447. Nor was *Newman* alone. The government’s lead prosecutor, “one of the most acclaimed prosecutors of his generation, is locked in what seems to be an escalating war of words with the federal judiciary,” facing a series of adverse rulings and judicial reprimands, James B. Stewart, *Some Fear Fallout From Preet Bharara’s Tension With Judges*, N.Y. TIMES, Apr. 16, 2015, <http://www.nytimes.com/2015/04/17/business/preet-bharara-and-federal-judges-trade-barbs-and-some-fear-consequences.html> [<https://perma.cc/M8W4-L6TG>].

323. [FA]

324. Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES, Oct. 5, 2013, <http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html> [<https://perma.cc/43Q3-RP4Z>] (quoting securities law practitioner Lewis D. Lowenfels).

325. *SEC ALJ in Bebo Case Refuses To Consider Constitutional Challenge and Denies More Time To Prepare Defense*, SECURITIES DIARY, (Apr. 8, 2015),

of utter deference to the agency.”<sup>326</sup> The corporate bar has worried not only that it is unlikely to win before administrative judges, but that the judges are unlikely to police the agency for overdoing it.<sup>327</sup>

The corporate bar appears to treasure this sort of equitable independence, but the public law community simply does not view its judges as the last bulwark of rights protection and regulatory ethics inducement. There is no comparable interest in equity and best practices among the repeat players of appellate litigation, agency general counsel’s offices, and industry groups.

In administrative law, the D.C. Circuit, which specializes in administrative law, certainly could make these sorts of pronouncements, but it does not chastise agencies for going too far, provided that they have stayed within the letter of their powers. Instead, that court either imposes regulatory

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<http://securitiesdiary.com/2015/04/08/sec-alj-in-bebo-case-refuses-to-consider-constitutional-challenge-and-denies-more-time-to-prepare-defense/> [<https://perma.cc/K7NS-EDZK>].

326. Jean Eaglesham, *SEC Wins Before Its In House Judges*, WALL ST. J., May 6, 2015, <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803> [<https://perma.cc/A8AH-UGZH>] (quoting an agency appeal).

327. See, for example, this profile of relatively new ALJ Cameron Elliot. Sarah Lynch, *SEC Judge Who Took On The ‘Big Four’ Known For Bold Moves*, REUTERS, Feb. 3, 2014, <http://www.reuters.com/article/2014/02/03/us-sec-china-elliott-idUSBREA1107P20140203> [<https://perma.cc/3TER-QLNT>] (“Defense attorneys say Elliot is viewed as being sympathetic to the agency’s enforcement division.”).

2016]

Zaring.A1Edit

207

requirements to reverse rules or defers to agencies when it looks like they have appropriately met their process obligations.

For example, while the SEC was investigating Gupta, Newman, and the Department of Justice was investigating KPMG, the SEC was also struggling to pass a number of rules that would have broadened its jurisdiction over, among other things, hedge funds,<sup>328</sup> fixed income securities,<sup>329</sup> and mutual fund board composition.<sup>330</sup> The D.C. Circuit reversed the agency's efforts in every single case.<sup>331</sup> The court urged the SEC to conduct a quantitative cost-benefit analysis before it would accede to the promulgation of the rules.<sup>332</sup> It said that the agency had a "statutory obligation to determine as best it can the economic implications of the rule it has proposed,"<sup>333</sup> and apprise itself of "the economic consequences of a proposed regulation before it decided whether to adopt the measure."<sup>334</sup> And it faulted the agency when it "failed adequately to quantify . . . certain costs or to explain why those costs could not be quantified."<sup>335</sup>

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328. *Bus. Roundtable & U.S. Chamber of Commerce v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

329. *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166 (D.C. Cir. 2010).

330. *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).

331. [FA]

332. [FA]

333. *Id.* at 143.

334. *Id.* at 144.

335. *Bus. Roundtable v. S.E.C.*, 647 F.3d 1144, 1149 (D.C. Cir. 2011).

This cutback was not based in equity, but rather on statutory interpretation, and reflected not a common law alteration of doctrine, but a purported attempt to use statutory interpretation to do what Congress putatively wanted the SEC to do.

Whatever the doctrine of administrative law applied to agency policymaking, and whether one believes that it has been applied honestly or not, the restraints offered by judges are not couched in equitable claims of best practices, fairness, and obligation. To be sure, pursuant to *Motor Vehicles Mfrs. Ass'n v. State Farm Ins. Co.*,<sup>336</sup> courts are required to take a “hard look” at agency action before affirming it.<sup>337</sup> A hard look sounds like a pretty principles-based, equitable-like inquiry, but in practice it is largely concerned with getting the agency to explain why it made the choice it did. As Jed Rakoff’s brother, Todd Rakoff has argued, in an article written with now-Judge David Barron, “*State Farm*. . . favor[s] a requirement that the

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336. [FA]

337. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). As Catherine Sharkey has explained, under “hard-look review, the reviewing court examines the administrative record and the agency’s explanation to determine whether the agency (1) relied on factors Congress did not intend it to consider, (2) entirely failed to consider an important aspect of the problem, (3) offered an explanation that runs counter to evidence before the agency, or (4) is so implausible that it could not be ascribed to the product of agency expertise.” Catherine M. Sharkey, *State Farm “With Teeth”*: Heightened Judicial Review in the Absence of Executive Oversight, 89 N.Y.U. L. REV. 1589, 1609 (2014).

2016]

Zaring.A1Edit

209

agency explain itself.”<sup>338</sup>

When it comes to administrative law, the courts do not regulate agencies on the basis of broad equitable principles.<sup>339</sup> Instead, they apply, cynically, or not, the procedural requirements of the APA and do or undo policies on that basis.

In my view, it is this difference that explains some of the disquiet by the corporate bar at the SEC’s new enforcement policy. ALJs, it is presumed, will not exercise any sort of equitable disquiet at agency overreaching. They will instead act like the proceduralists of administrative law act, with a focus more on whether the agency has met its legal requirements, rather than whether it is treating defendants fairly compared to some baseline that those with a nuanced understanding of what equity requires will know has been breached.

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338. David J. Barron, Todd D. Rakoff, *In Defense of Big Waiver*, 113 Colum. L. Rev. 265, 330 (2013).

339. Or, at least, they do not do so ordinarily. In *FDA v. Brown & Williamson*, the Court refused to permit the FDA to regulate cigarettes, even though it had an exceedingly plausible textual argument that its government statute permitted it to regulate drugs (nicotine is a drug) and drug delivery devices (cigarettes deliver nicotine to the body) because the jurisdictional expansion would be enormous. *See* *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 160 (2000). As the Court put it, “Given this history and the breadth of the authority that the FDA has asserted, we are obliged to defer not to the agency’s expansive construction of the statute, but to Congress’ consistent judgment to deny the FDA this power.” *See id.* at 360.

Indeed, ALJs perform this function as part of the agency, subordinates to their commissioners. Congress considered and rejected the possibility that the adjudicators could be given the independence that might permit sweeping equitable reviews of agency policy when it chose to locate appeals from ALJ decisions to the agency heads from whom they work, rather than to a centralized panel of administrative adjudicators.<sup>340</sup> The APA very explicitly provides that “on appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision.”<sup>341</sup> In doing so it has embraced the idea that the policy decisions are for the agency heads, not the ALJs. The thought was that it would, in the words of one ALJ, make clear that ALJs “act on behalf of those agencies,” and that therefore “they are often expected to help achieve agency objectives.”<sup>342</sup> That, in turn, make the agency action filtered through adjudicators ultimately the responsibility of the agency’s politically accountable commissioners.<sup>343</sup>

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340. For a review of this history, see James E. Moliterno, *The Administrative Judiciary’s Independence Myth*, 41 *Wake Forest L. Rev.* 1191, 1227 (2006).

341. 5 U.S.C. § 557(b) “on appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision. . .” the APA definitely has baked in the idea that the policy decisions are for the agency heads, not the ALJs.

342. Edwin L. Felter, Jr., *Maintaining the Balance Between Judicial Independence and Accountability in Administrative Law*, *JUDGES’ J.*, Winter 1997, at 22.

343. And there are good reasons for this. See Jim Rossi, *Final, but Often Fallible: Recognizing Problems with ALJ Finality*, 56 *ADMIN. L. REV.* 53, 64 (2004) (“Since most ALJs operate as merit

2016]

Zaring.A1Edit

211

Of course, it would be overstating the case to suggest that administrative adjudicators could never possibly care about whether the agencies they supervise were transgressing some hazy standards of good practice provided their filings are timely, just as it is unlikely that Manhattan and Delaware judges are uninterested in procedural default. But, to me, the most interesting aspect of the ALJ controversy is the light it sheds on the two very different worldviews served by the two different sorts of adjudication at issue. One is interested in moon-shot but wholesale rebukes of agencies, the other in bureaucratic regularity, and the prospect of the replacement of equity-minded judges with routinized and procedurally minded adjudicators has, I think, galvanized the controversy over SEC ALJs.

Accordingly, despite their doctrinal missteps, it is surely true that the corporate bar critics are onto something. Judge (Jed) Rakoff suspects ALJs of being susceptible to a “narrow, tunnel vision view of the law.”<sup>344</sup> As we have seen, much of their work *is* routine, although there is no indication that

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appointees—and are not subject to the same political accountability constraints as agency heads—the result of ALJ final order authority on issues of law and policy is less political accountability for agency decision-making. ALJ finality also values generalist decision-making over expert-based decision-making, and thus comes at some cost for expertise in agency decision-making.”).

344. Stephanie Russell-Kraft, *Rakoff Continues Crusade Against SEC Admin Courts*, LAW360, Nov. 21, 2014, <http://www.law360.com/articles/598561/rakoff-continues-crusade-against-sec-admin-courts> [<https://perma.cc/2QBH-BUBJ>] (reporting on Rakoff’s remarks at a panel at Columbia Law School).

they are not independent; they are certainly capable of reversing the agency. Perhaps to indicate his independence, one SEC ALJ has announced that he will apply the *Newman* rule to his insider trading cases—despite the fact that his agency believes *Newman* to have been wrongly decided.<sup>345</sup> But since Dodd-Frank, ALJs have taken no grand stands, with the possible exception of the later versed decision to throw out an agency effort to bring a financial crisis case against State Street’s sellers of packaged debt obligations, and it is difficult to imagine an ALJ deeming such a stand to be something that belongs in their toolkit.<sup>346</sup>

### Conclusion

The SEC’s ALJ program has aroused a great deal of consternation in the corporate law community because of a not unjustified belief that administrative proceedings are less likely to turn on the sort of equitable considerations that animate, on occasion, judges who sit in courts to cut back on what they perceive as particularly aggressive law enforcement against

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345. “‘I am going to follow *Newman* dicta,’ [ALJ] Patil said: at the end of a preliminary hearing in an insider trading case involving an analyst and a trader (both of whom would like be registered with the SEC. Stephanie Russell-Kraft, *SEC Admin Judge Will Apply Newman To Insider Trading Case*, LAW360, Feb. 11, 2015, <http://www.law360.com/articles/620709/sec-admin-judge-will-apply-newman-to-insider-trading-case> [<https://perma.cc/Y9S5-PAPJ>]. Of course, the indictment certainly works well for those who would like to chasten regulators before they try to regulate.

346. See *supra* notes 137–138 and accompanying text.



2016]

Zaring.A1Edit

213

corporate defendants. That does not make the SEC's decision to route more proceedings to its ALJs illegal: the idea that SEC ALJs must have a record of equitable relief is not required by doctrine, and may not be consistent with the facts of ALJ adjudication, where the agency does not always win. It is, however, a telling example of how that corporate and administrative lawyers view the methods and ends of adjudication differently. As corporate law becomes ever more regulatory, its legal community will have to come to terms with a different vision of what tribunals are for – or it will have to find some new converts.

[Appendix will be reinserted]