

SEC AND CFTC ADMINISTRATIVE PROCEEDINGS

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INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”)¹ authorized the Securities and Exchange Commission (“SEC”) to impose civil penalties in proceedings before an administrative law judge (“ALJ”) against any person who violated any provision of the federal securities laws or any rule promulgated under those statutes. Prior to Dodd-Frank, the SEC’s authority to impose civil penalties in an administrative proceeding (“AP”) was limited to registered entities and persons associated with registered entities—primarily broker-dealers and investment advisers. For all other defendants the SEC was required to file a civil enforcement action in federal court. One consequence of this limitation was that the SEC historically commenced only 60% of its new cases as APs.² Subsequent to Dodd-Frank that percentage has increased significantly. More than 80% of the SEC’s new enforcement actions in the first three quarters of fiscal year 2016 were filed as administrative proceedings³ and this was consistent with the pattern in 2015 and 2014.⁴ The trend is even more dramatic with respect to public company defendants. The proportion of SEC enforcement actions commenced as APs against such defendants more than tripled from 21% in fiscal year 2010 to 76% in fiscal year 2015.⁵ In the first half of fiscal year

¹ Pub. L. 111-203, 124 Stat. 1376 (2010).

² Sara Gilley, Heather Lazur & Alberto Vargas, *SEC Focus on Administrative Proceedings: Mid-year Checkup*, LAW360 (May 27, 2015, 10:25 AM), <http://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup> (citing SEC data showing the use of administrative APs for 63-64% of enforcement actions in fiscal years 2010-2012, 69% in 2013, and a sharp increase to 81% and 82% in fiscal years 2014 and 2015, respectively).

³ CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY DIPS IN 2016 (2016), <https://www.cornerstone.com/Publications/Research/SEC-Enforcement-Activity-Dips-in-2016> (showing that 81% of SEC enforcement actions filed in the first three quarters of fiscal year 2016 were filed as APs).

⁴ Gilley, Lazur & Vargas, *supra* note 2.

⁵ Stephen Choi, Sara E. Gilley & David F. Marcus, *SEC Enforcement Activity Against Public Company Defendants: Fiscal Years 2010–2015*, N.Y.U. POLLACK CTR. FOR LAW & BUS. & CORNERSTONE RESEARCH, at 6 (2016), <https://www.cornerstone.com/GetAttachment/>

2016, the SEC commenced 88% of its enforcement actions against public company defendants and related subsidiary defendants as administrative proceedings.⁶ The Commodity Futures Trading Commission (“CFTC”) has announced that it too will pursue an increasing number of enforcement actions in administrative proceedings.⁷

SEC ALJs are SEC employees and are paid by the agency. They are hired by the SEC’s Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, and the Office of Personnel Management (“OPM”), rather than by the President, a court of law, or the head of a federal department. SEC ALJs—like other federal ALJs—arguably are insulated from the President by dual layers of for-cause removal protection. If an SEC enforcement action is assigned to an ALJ, rather than to a federal judge, there are major adverse procedural consequences for respondents. There is very limited discovery, neither the Federal Rules of Civil Procedure nor the Federal Rules of Evidence apply, there is no opportunity to assert counterclaims, there is no right to a jury trial on any issue, and the time frame for completion of the administrative proceeding is both rigid and truncated.

Coincidentally or not, the SEC has been much more successful in administrative proceedings conducted on its home court than it has been in federal court. During the time period October 2010 to September 2015 the SEC prevailed against 86% of respondents in contested cases heard by ALJs.⁸ During the same period the SEC had a considerably lower success rate of 70% in federal court.⁹ The statis-

5c823caf-b6b7-47b5-ba2f-1c991fef68c7/SEC-Enforcement-Activity-Against-Public-Company-Defendants.pdf (presenting data showing that 21% of the thirty-eight SEC actions against public companies in 2010 were administrative proceedings, increasing to 76% of thirty-four enforcement actions in 2015).

6 Stephen Choi et al., *SEC Enforcement Activity Against Public Companies and Their Subsidiaries: Midyear FY 2016 Update*, at 4 (2016), N.Y.U. POLLACK CTR. FOR LAW & BUS. & CORNERSTONE RESEARCH, <https://www.cornerstone.com/GetAttachment/1a6f93a7-3859-4e7e-841f-65241c49c123/SEC-Enforcement-Activity-against-Public-Companies.pdf> (showing that 88% of the forty-three SEC actions against public companies and related subsidiaries in the first half of fiscal year 2016 were brought as administrative proceedings).

7 See Jimmy Hoover, *CFTC Closer to In-House Enforcement Actions, Official Says*, LAW360 (Mar. 12, 2015, 7:03 PM), <http://www.law360.com/articles/630881/cftc-closer-to-in-house-enforcement-actions-official-says> (“CFTC Enforcement Director Aitan Goelman said the agency will ‘very soon’ follow the SEC’s shift to litigating enforcement actions in-house . . .”).

8 Jean Eaglesham, *Fairness of SEC Judges Is in Spotlight*, WALL ST. J. (Nov. 22, 2015, 9:25 PM), <http://www.wsj.com/articles/fairness-of-sec-judges-is-in-spotlight-1448236970> (“The SEC won against 86% of defendants in contested cases in its own courts from October 2010 through September 2015 . . . significantly higher than the agency’s 70% win rate in federal court.”).

9 *Id.*

tics concerning appeals are even starker. The first level of appeal in an SEC administrative proceeding is to the five SEC Commissioners, who also authorize the initiation of enforcement proceedings.¹⁰ The Commissioners decided in the agency's favor concerning 95% of appeals taken during the period October 2010 to March 2015.¹¹

The foregoing picture has prompted numerous respondents to file constitutional challenges to SEC administrative proceedings.¹² Many of those cases were filed in 2014 and 2015, and by April 2016 appeals were pending in multiple federal circuits.¹³ In 2016 the Supreme Court denied *certiorari* in two such cases,¹⁴ but the Court is widely expected to ultimately resolve one or more of the constitutional issues.¹⁵

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- 10 See Daniel R. Walfish, *The Real Problem with SEC Administrative Proceedings, and How to Fix it*, FORBES (July 20, 2015, 7:55 AM), <http://www.forbes.com/sites/danielfisher/2015/07/20/the-real-problem-with-sec-administrative-proceedings-and-how-to-fix-it/> (noting that “[t]he Commissioners insist on authorizing all enforcement proceedings, whether filed in district court or administratively”).
- 11 Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015, 10:30 PM), <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803> (highlighting that “the commissioners decided in their own agency’s favor concerning 53 out of 56 defendants in appeals—or 95%—from January 2010 through [March 2015].”).
- 12 Carmen Germaine, *11th Circ. Won’t Lift Order Blocking SEC In-House Suit*, LAW360 (Oct. 7, 2015, 9:02 PM), <http://www.law360.com/articles/711691/11th-circ-won-t-lift-order-blocking-sec-in-house-suit> (noting that approximately a dozen defendants have asserted constitutional challenges in federal court).
- 13 See Carmen Germaine, *Justices Reject Another Challenge to SEC In-House Court*, LAW360 (Apr. 25, 2016, 9:49 AM), <http://www.law360.com/articles/788362/justices-reject-another-challenge-to-sec-in-house-court>. By September 2016, all four federal circuits to have ruled on the issue agreed that federal courts have no subject matter jurisdiction to hear constitutional claims raised by respondents in on-going administrative proceedings, and review of such claims can only be provided on appeal from final decisions by the SEC. See *Hill v. SEC*, 825 F.3d 1236, 1252 (11th Cir. 2016); *Tilton v. SEC*, 824 F.3d 276, 291 (2d Cir. 2016); *Jarkesy v. SEC*, 803 F.3d 9, 29 (D.C. Cir. 2015); and *Bebo v. SEC*, 799 F.3d 765, 775 (7th Cir. 2015). An examination of the jurisdictional issue is beyond the scope of this Article.
- 14 *Pierce v. SEC*, 786 F.3d 1027 (D.C. Cir. 2015), *cert. denied*, 84 U.S.L.W. 3416 (U.S. Apr. 25, 2016) (No. 15-901); *Bebo v. SEC*, 799 F.3d 765 (7th Cir. 2015), *cert. denied*, 84 U.S.L.W. 3438 (U.S. Mar. 28, 2016) (No. 15-997).
- 15 See, e.g., Jason M. Halper, Robert M. Loeb, Kelsi Corkran & Marc R. Shapiro, *SEC In-House Forum Is Constitutionally Uncertain*, NAT’L L.J., May 30, 2016, <http://www.nationallawjournal.com/id=1202758804344/SEC-InHouse-Forum-Is-Constitutionally-Uncertain?slreturn=20160817064919> (“[E]ventual resolution by the Supreme Court seems likely.”); Ed Beeson, *SEC’s 7th Circ. Win Won’t End War on Admin Courts*, LAW360 (Aug. 31, 2015), <http://www.law360.com/articles/696738/sec-s-7th-circ-win-won-t-end-war-on-admin-courts> (citing Andrew Vollmer, Professor, University of Virginia School of Law, for the proposition that the Supreme Court is likely to take up a constitutional challenge to the SEC’s use of ALJs, even if no circuit split on the issue emerges).

This Article examines five of the most common constitutional arguments asserted by respondents: denial of due process, denial of equal protection, violation of the Seventh Amendment, and two distinct violations of Article II of the U.S. Constitution. It then examines two common normative arguments concerning the use by the SEC and CFTC of administrative proceedings—the process impedes the balanced development of the federal securities laws and even if the process is constitutional it is fundamentally unfair, or at least raises a substantial perception of unfairness. Finally, this Article examines four potential solutions to the multiple problems that have been identified. This Article concludes that (1) SEC and CFTC administrative proceedings likely are constitutional in most, but not all, respects and (2) there is a sound normative basis for reforming the process. The Article recommends that the SEC modify its practices for hiring ALJs and that the SEC and CFTC make major revisions to their respective Rules of Practice.

I. ADMINISTRATIVE CREEP AT THE SEC AND CFTC

The first Part of this Article examines what prominent United States District Judge Jed S. Rakoff has described as a classic case of administrative creep¹⁶—the recent trend for the SEC to utilize an administrative forum for enforcement actions. As will be seen, this trend is unmistakable at the SEC and the CFTC has declared its intent to follow suit. This Part also will examine the SEC’s home court success and key aspects of the administrative process at the SEC and CFTC.

A. *The SEC Shift*

The federal ALJ position was created by the Administrative Procedure Act of 1946 (“APA”)¹⁷ and in the seven decades since then has

¹⁶ Judge Jed S. Rakoff, *PLI Securities Regulation Institute Keynote Address, Is the S.E.C. Becoming a Law Unto Itself?*, at 6 (Nov. 11, 2014), <https://securitiesdiary.files.wordpress.com/2014/11/rakoff-pli-speech.pdf> (“[I]t is hard to find a better example of what is sometimes disparagingly called ‘administrative creep’ than this expansion of the S.E.C.’s internal enforcement power.”).

¹⁷ Pub. L. 79-404, 60 Stat. 237 (1946). When the APA was enacted ALJs were called “hearing examiners.” The title was changed by Congress to “Administrative Law Judge” in 1978. See Pub. L. 95-251, 92 Stat. 183 (1978); United States Government Accountability Office, GAO-10-14, *Results-Oriented Cultures: Office of Personnel Management Should Review Administrative Law Judge Program to Improve Hiring and Performance Management* 4 n.9 (Jan. 2010), <http://www.gao.gov/products/GAO-10-14> (stating that the APA established the position of hearing examiner, which was changed to administrative law judge in 1978).

become extraordinarily important. The more than 1600 federal ALJs significantly outnumber Article III judges, preside over all formal adjudications within the executive branch, and annually decide more than 250,000 cases.¹⁸ Many of these cases are decided by SEC ALJs. The SEC has been using administrative proceedings for more than forty years—even before its Division of Enforcement (“Division”) was created in August 1972.¹⁹ But their use was limited. Prior to the enactment of Dodd-Frank in 2010 the SEC was restricted in both the types of cases it could bring administratively and in the remedies it could obtain in such proceedings.²⁰ In large part as a function of these restrictions the SEC annually commenced only approximately 60% of its new enforcement cases as administrative proceedings.²¹ During fiscal years 1998–2009 this proportion remained relatively stable, ranging between 47% and 62%.²²

Dodd-Frank § 929P(a) authorized the SEC to obtain in administrative proceedings remedies that are essentially identical to those it can obtain in federal district court actions.²³ This was the most signif-

18 Kent Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 799, 852 (2013) (noting that the number of ALJs is almost double the 874 Article III judges, that these ALJs decide more than 250,000 cases each year, and that they “hear evidence, decide factual issues, and apply legal principles in all formal administrative adjudications under the [APA]”).

19 Andrew Ceresney, *Remarks to the American Bar Association’s Business Law Section Fall Meeting* 3 (Nov. 21, 2014) [hereinafter, *Ceresney Remarks*], <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297> (“[W]e 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.”).

20 This Article refers to administrative proceedings and cease-and-desist proceedings collectively as “administrative proceedings,” but they are distinct enforcement actions. In a majority of cases, an SEC enforcement action is commenced as both forms. Douglas Davison, Mathew Martens, Nicole Rabner, John Valentine & Natalie Rastin, *Litigating with—and at—the SEC*, 48 REV. SEC. & COMMOD. REG. 103, 104–105 (2015) (explaining that there are two kinds of enforcement actions, administrative proceedings and cease-and-desist proceedings, collectively known as administrative proceedings, and that most enforcement actions are initiated as both).

21 Gilley, Lazur & Vargas, *supra* note 2; *cf.* Sonia A. Steinway, Comment, *SEC “Monetary Penalties Speak Very Loudly,” But What Do They Say? A Critical Analysis of the SEC’s New Enforcement Approach*, 124 YALE L.J. 209, 226 (2014) (noting that SEC civil cases “outnumbered administrative proceedings as recently as 2005”).

22 MARC B. DORFMAN & KENNETH B. WINER, *SECURITIES ENFORCEMENT: COUNSELING AND DEFENSE* § 19.01 (2014) (“During fiscal years 1998 through 2009, the number of administrative proceedings as a percentage of total enforcement actions initiated remained relatively stable, ranging between 47% and 62%”). *Cf.* Urska Velikonja, *Reporting Agency Performance: Behind the SEC’s Enforcement Statistics*, 101 CORNELL L. REV. 901, 964 (2016) (stating that during the last fifteen years the SEC commenced approximately half of its enforcement actions as APs).

23 15 U.S.C. § 78d-5 (2012). One remaining difference is that if the SEC seeks an order issued pursuant to Section 21(d)(2) of the Securities Exchange Act prohibiting a person

icant expansion of the SEC's authority to use administrative enforcement in its more than eighty-year history.²⁴ Why did Congress include § 929P(a) in the statute? The scant legislative history indicates that the SEC and Congress primarily hoped to enhance the Division's efficiency²⁵—and administrative enforcement generally is both quicker²⁶ and less expensive²⁷—but Congress devoted little or no time to considering the multiple ramifications of § 929P(a) when Dodd-Frank was being shaped. Neither the House nor the Senate debated the inclusion of this section.²⁸

The SEC has taken advantage of its new authority, although it did not do so right away. Post-Dodd-Frank, the percentage of new enforcement actions the SEC has commenced administratively increased from 63% in fiscal year 2010 to 69% in fiscal year 2013, 81%

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- from serving as an officer or director of a public company it can only obtain that order from a federal judge. GIBSON, DUNN & CRUTCHER LLP, *The Dodd-Frank Act Reinforces and Expands SEC Enforcement Powers* (July 21, 2010), <http://www.gibsondunn.com/publications/pages/Dodd-FrankActReinforcesAndExpandsSECEnforcementPowers.aspx>.
- 24 Chris Cox, *The Growing Use of SEC Administrative Proceedings: An Historical Perspective from Congress and the Agency*, at 3, Speech Presented at Securities Enforcement Forum West (May 13, 2015), <http://www.securitiesdocket.com/wp-content/uploads/2015/05/2015-05-13-Speech-to-Securities-Enforcement-Forum-West-San-Francisco.pdf> (noting that “the most significant expansion of AP authority in the SEC’s 81-year history” was § 929P(a)).
- 25 Rakoff, *supra* note 16 (observing that SEC enforcement actions brought internally are more efficient because discovery is much more limited).
- 26 See Cox, *supra* note 24, at 6 (“In an AP, the whole thing normally does get wrapped up within 300 days, which would be very difficult to achieve in a civil trial.”); Peter J. Henning, *Choosing the Battlefield in S.E.C. Cases*, N.Y. TIMES: DEALBOOK (May 11, 2015), http://www.nytimes.com/2015/05/12/business/dealbook/choosing-the-battlefield-in-sec-cases.html?_r=0 (“The benefit of an administrative proceeding is a quicker resolution because the S.E.C.’s rules generally mandate an initial decision within no more than 300 days of filing, far quicker than federal court cases that can take years to resolve.”). *But see* U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices* 16 (July 2015), http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf (“[T]he overall period for completion of an administrative proceeding is likely slower than the time required to complete a trial in district court.”).
- 27 See Andrew Ceresney, Director, SEC Division of Enforcement, Keynote Speech at New York City Bar 4th Annual White Collar Institute (May 12, 2015) [hereinafter, *Ceresney Keynote Speech*], <http://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-keynote.html> (noting that the SEC expends fewer resources in administrative proceedings than it does in judicial proceedings).
- 28 Cox, *supra* note 24, at 3 (noting that § 929P(a) “was not even debated in either the House or the Senate consideration of the bill”). *Cf.* QUINN EMANUEL URQUHART & SULLIVAN, LLP, *Circuit Courts Align to Shield SEC Administrative Proceedings from Collateral Attack* (Aug. 2016), <http://www.quinnemanuel.com/the-firm/news-events/article-august-2016-circuit-courts-align-to-shield-sec-administrative-proceedings-from-collateral-constitutional-attack/> (“The intent was clear—make the SEC’s authority in administrative proceedings ‘coextensive with its authority to seek penalties in Federal court.’”).

in fiscal year 2014, and 81% in the first three quarters of fiscal year 2016.²⁹ These percentages translate to hundreds of new administrative proceedings each year—in fiscal year 2015 the SEC commenced a total of 807 new enforcement actions, up from 755 new actions in 2014.³⁰

The SEC's shift to an administrative forum has been reflected in three areas that it has designated as high priority for enforcement: insider trading, violations of the Foreign Corrupt Practices Act ("FCPA"), and financial reporting fraud. The SEC announced its decision in 2014³¹ to increase its use of APs in insider trading cases soon after it lost two such cases in federal district court.³² In fiscal year 2013 the SEC filed only 2% of its insider trading cases in-house, but this figure increased to 23% in fiscal year 2014 and 35% in the first half of fiscal year 2015.³³ This translates to dozens of in-house proceedings—in fiscal year 2015 the SEC brought a total of eighty-seven insider trading cases.³⁴ The SEC's preference to litigate insider trad-

²⁹ CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY DIPS IN 2016 (Aug. 2016), <https://www.cornerstone.com/Publications/Research/SEC-Enforcement-Activity-Dips-in-2016>;

Gilley, Lazur & Vargas, *supra* note 2.

³⁰ Jimmy Hoover, *SEC Predicts Record Enforcement Levels Will Continue in 2016*, LAW360 (Mar. 10, 2016, 3:10 PM), <http://www.law360.com/articles/769941/sec-predicts-record-enforcement-levels-will-continue-in-2016> (observing that the 807 new enforcement actions in 2015 topped the prior record high of 755 such actions in 2014).

³¹ Sarah N. Lynch, *SEC to File Some Insider Trading Cases in its In-House Court*, REUTERS (June 11, 2014, 4:12 PM), <http://www.reuters.com/article/2014/06/11/us-sec-insidertrading-idUSKBN0EM2DI20140611> ("The SEC's planned shift follows a string of recent trial losses involving insider trading.").

³² Michael S. Piwowar, Commissioner, Securities and Exchange Commission, *Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly, and Efficient SEC* (Feb. 20, 2015), <http://www.sec.gov/news/speech/022015-spchcm.html> (commenting that "[a]nnouncement of this plan to increase the use of administrative proceedings in insider trading cases followed the Commission's loss in two insider trading cases in federal court").

³³ Gilley, Lazur & Vargas, *supra* note 2. The statistics are less compelling if one considers the venue for *litigated* insider trading cases. Since the beginning of fiscal year 2014 approximately 90% of the SEC's litigated insider trading cases have been filed in federal court. *Ceresney Keynote Speech*, *supra* note 25 (noting that, beginning in fiscal year 2014, approximately 90% of the SEC's litigated insider trading cases were filed in federal court).

³⁴ John C. Wander, *New Records in SEC Enforcement Actions*, HARV. LAW SCH. FORUM ON CORP. GOV. & FIN. REG. (Nov. 14, 2015), <http://corpgov.law.harvard.edu/2015/11/14/new-records-in-sec-enforcement-actions/>. See also Robert Anello, *Addressing the SEC's Administrative "Home Court" Advantage in Enforcement Proceedings*, FORBES (Sept. 7, 2015, 4:40 PM), <http://www.forbes.com/sites/insider/2015/09/07/addressing-the-secs-administrative-home-court-advantage-in-enforcement-proceedings/> ("[I]nsider trading cases, traditionally heard by federal district judges, now routinely are brought before SEC administrative law judges (ALJs).").

ing in-house is understandable. Such cases “are virtually the only cases that the SEC frequently litigates based simply on circumstantial evidence.”³⁵ The Division probably assumes, correctly, that an SEC ALJ will be more receptive to such evidence than would a federal jury. Indeed, from June 2013 to August 2014, twenty-one individuals prevailed against the SEC in thirteen insider trading cases commenced in federal court, either on summary judgment or at trial.³⁶ During the same period, the SEC had only one trial win and prevailed only once on summary judgment in insider trading cases.³⁷

The SEC’s preference to litigate insider trading in-house was widely expected to intensify³⁸ following the Second Circuit’s 2014 decision in *Newman v. United States*,³⁹ which raised the bar for the government to prove that an offense occurred.⁴⁰

In recent years enforcement of the FCPA has been a priority for both the Department of Justice (“DOJ”) and the SEC,⁴¹ but the

³⁵ Stephen J. Crimmins, *Insider Trading: Where is the Line?*, 2013 COLUM. BUS. L. REV. 330, 362–63 (2013). Accord Joel M. Cohen, Mary Kay Dunning & Darcy Harris, *SEC Plans to Play Insider-Trading Cases on Home Court*, NAT’L L.J. (Sept. 16, 2014) (“The SEC rarely has the type of ‘smoking gun’ evidence presented in criminal insider-trading prosecutions; there generally are no cooperating witnesses and no wiretaps or other directly incriminating evidence.”).

³⁶ MORRISON & FOERSTER, LLP, *2014 Insider Trading Annual Review* (Jan. 2015), <http://www.mofo.com/~media/Files/ClientAlert/2015/02/150211InsiderTradingAnnualReview.pdf> (contrasting wins against the SEC by twenty-one individuals in thirteen insider trading cases in federal court with the SEC’s one trial victory and one summary judgment victory).

³⁷ *Id.*

³⁸ See, e.g., Michael R. McPhail & Daniel R. Kelley, *Life After Newman: The SEC May Shift Toward Administrative Proceedings in Insider-Trading Cases*, 47 BLOOMBERG BNA SEC. REG. & L. REP. 2238 (Nov. 23, 2015), (anticipating increase in SEC use of administrative proceedings to litigate insider trading).

³⁹ 773 F.3d 438 (2d Cir. 2014), *abrogated by* *Salman v. United States*, No. 15-628, 2016 WL 7078448 (U.S. Dec. 6, 2016).

⁴⁰ *Newman* held that in order to sustain a conviction for insider trading, the government must prove beyond a reasonable doubt that the tippee knew that an insider disclosed inside information and that he did so in exchange for personal benefit. *Id.* at 450. To prove personal benefit the government must prove “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.” *Id.* at 452.

⁴¹ SHEARMAN & STERLING, LLP, *Recent Trends and Patterns in FCPA Enforcement*, FCPA DIGEST, Jan. 2016, at iv, <http://www.shearman.com/~media/Files/NewsInsights/Publications/2016/01/FCPA-Digest.pdf> (“DOJ and SEC officials have made clear that the FCPA will remain a priority for both agencies and we see no reason to question those officials’ sincerity.”). In 2015 the number of resolved FCPA enforcement actions dropped to its lowest level since 2006, but this decline appears to have been an outlier. The pace of enforcement activity increased sharply in 2016. Marc Alain Bohn & Michael Skopets, *Uptick in FCPA Enforcement Suggests 2015 Drop Was Outlier*, LAW360 (May 18, 2016, 11:25 AM), <http://www.law360.com/articles/795489/uptick-in-fcpa-enforcement-suggests-2015-drop-was-outlier>.

Commission rarely utilized administrative proceedings in such cases prior to the enactment of Dodd-Frank. Because it lacked authority to impose civil monetary penalties in administrative actions, the SEC not infrequently utilized a bifurcated approach, suing in federal court for civil penalties while simultaneously seeking both disgorgement and a cease-and-desist order from an in-house ALJ.⁴² Post-Dodd-Frank the landscape has changed. In fiscal year 2011 the SEC filed only 20% of its FCPA cases in-house, but this figure increased to 57% in fiscal year 2014 and 89% in the first half of fiscal year 2015.⁴³ Many of the recent FCPA administrative proceedings exceed prior proceedings in both size and scope.⁴⁴ The SEC has described its use of administrative proceedings in FCPA cases as “the new normal.”⁴⁵

The situation regarding financial reporting fraud is similar. Financial reporting has long been one of the SEC’s core focus areas. But after a period of extensive enforcement activity in the early 2000s, and a brief resurgence featuring stock option backdating cases,⁴⁶ the SEC’s focus in this area began to wane. During the period 2006–2012 the number of open SEC investigations concerning financial reporting or disclosure dropped from 304 to 124, while the number of cases filed by the SEC in this subject area plummeted almost 70%, from 219 in 2007 to sixty-eight in 2013.⁴⁷ The tide turned again in 2013,

42 Bruce E. Yannett, Andrew M. Levine & Steven S. Michaels, *The Total S.A. Action: Are Administrative Orders the SEC’s FCPA Resolution of Choice for the Future?*, DEBEVOISE & PLIMPTON, LLP, 4 FCPA UPDATE, July 2013, at 1–2, 5–6, http://www.debevoise.com/~media/files/insights/publications/2013/07/fcpa%20update/files/view%20fcpa%20update/fileattachment/fcpa_update_july_2013.pdf.

43 Gilley et al., *supra* note 2. See also SHEARMAN & STERLING, LLP, *supra* note 41, at v (“[T]he majority of the SEC’s FCPA enforcement actions have been resolved using administrative proceedings . . .”).

44 Marc Alain Bohn, *Are Administrative Proceedings the New Civil Complaint?*, FCPA BLOG (May 6, 2014, 7:28 AM), <http://www.fcpablog.com/blog/2014/5/6/are-administrative-proceedings-the-new-civil-complaints.html#>.

45 COVINGTON & BURLING, LLP, TRENDS AND DEVELOPMENTS IN ANTI-CORRUPTION ENFORCEMENT, 12 (Winter, 2015), https://www.cov.com/~media/files/corporate/publications/2015/01/trends_and_developments_in_anti-corruption_enforcement_winter_2015.ashx.

46 See Quinn Curtis & Minor Myers, *Do the Merits Matter? Empirical Evidence on Shareholder Suits from Options Backdating Litigation*, 164 U. PA. L. REV. 291, 306–10 (2016) (describing the backdating scandal).

47 Randall J. Fons, *SEC Investigations and Enforcement Related to Financial Reporting and Accounting*, HARV. L. SCH. F. ON CORP. GOV’T AND FIN. REG. (Feb. 16, 2014), <http://corpgov.law.harvard.edu/2014/02/16/sec-investigations-and-enforcement-related-to-financial-reporting-and-accounting/>; MORRISON & FOERSTER, LLP, *Annual Review 2013*, FIN. REPORTING + ACCT., Jan. 2014, at 1, <http://media.mofo.com/files/Uploads/Images/140123-Financial-Reporting-Accounting-Enforcement-Annual-Review.pdf>.

when Mary Jo White became SEC chairwoman and the agency established a twelve-member Financial Reporting and Audit Task Force dedicated to proactively detecting fraudulent or improper financial reporting.⁴⁸ The SEC doubled the number of its financial reporting and disclosure enforcement actions between 2013 and 2015.⁴⁹ In fiscal year 2015 these often complex actions represented 20% of the SEC's enforcement docket—the largest percentage in many years and the single largest component of the agency's 2015 docket.⁵⁰ The SEC's renewed focus in this area—no doubt aided by new technology that enables the agency to “review terabytes of information in financial statements almost simultaneously”⁵¹—has been accompanied by a shift toward the use of administrative proceedings. Whereas during the period 2011–2013 the SEC filed only 57% of its enforcement actions for financial reporting fraud and issuer disclosure violations as administrative proceedings, this figure increased to 88% in fiscal year 2014⁵² and the trend continued in 2015.⁵³

For multiple reasons the foregoing raw numbers overstate the case. First, the SEC continues to try many cases in federal court. Indeed, in fiscal year 2014 the SEC tried more cases (thirty) in federal court than in any of the prior ten years.⁵⁴ The agency is likely to continue pursuing numerous enforcement actions in federal court, because such actions are more visible and function as an important de-

⁴⁸ See William R. McLucas et al., *Update: SEC's Financial Reporting and Audit Task Force*, WILMER CUTLER PICKERING HALE & DORR, LLP (Feb. 20, 2014), <https://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=10737423412> (describing the objectives, operations, and initiatives of the Task Force); Marc J. Fagel & Courtney M. Brown, *SEC Picks Up the Pace on Financial Reporting Fraud Efforts*, LAW360 (Oct. 26, 2015, 11:03 AM), <http://www.law360.com/articles/717743/sec-picks-up-the-pace-on-financial-reporting-fraud-efforts> (“The SEC's recent wave of filings should leave little doubt that the Division of Enforcement is intensely focused on identifying and bringing financial reporting cases.”).

⁴⁹ Stewart Bishop, *SEC Official Talks Up Sharp Accounting Fraud Focus*, LAW360 (June 3, 2016, 9:25 PM), <http://www.law360.com/articles/803600/sec-official-talks-up-sharp-accounting-fraud-focus>.

⁵⁰ Marc J. Fagel, *SEC Enforcement by the Numbers*, LAW360 (Mar. 8, 2016, 10:05 AM), <http://www.law360.com/articles/768287/sec-enforcement-by-the-numbers>.

⁵¹ Robert F. Carangelo, Paul A. Ferrillo & Andrew Cauchi, *Guest Post: The SEC's Renewed Focus on Financial Reporting and Financial Fraud*, D&O DIARY (May 19, 2016), <http://www.dandodiary.com/2016/05/articles/securities-laws/the-secs-renewed-focus-on-financial-reporting-and-financial-fraud/>.

⁵² Gilley et al., *supra* note 2.

⁵³ The SEC's accounting and auditing enforcement releases (“AAERs”) serve as a prime indicator of enforcement activity in this area. In the first half of fiscal year 2015, 93% of the SEC's AAERs were filed as administrative proceedings, compared with 74% in the first six months of fiscal year 2014 and 63% in the first six months of fiscal year 2013. *Id.*

⁵⁴ *Ceresney Remarks*, *supra* note 19.

terrent. Second, contrary to claims by some critics that the SEC has shifted to administrative enforcement partly because it keeps losing in federal district court,⁵⁵ by May 2015 the SEC had won twelve of its fourteen most recent jury trials.⁵⁶ In fiscal year 2015 the SEC won all six of its jury or bench trials.⁵⁷

Third, many SEC administrative proceedings are routine—they include, for example, actions to suspend trading in companies whose filings are not current, as well as follow-on actions to sanction brokers or investment advisers previously found liable for securities laws violations.⁵⁸ A 2015 report concluded that the large number of these mostly ministerial APs “has an enormous distorting impact on annual statistics,”⁵⁹ and it is difficult to quibble with that conclusion. In calendar year 2014 SEC ALJs issued 183 initial decisions. Of these, 119 terminated the registration of public companies for failure to file periodic reports (113 of which were resolved by a default order), and forty-four were follow-on APs (all of which were resolved without a hearing, in the form of default judgments or motions for summary disposition).⁶⁰ More recently, the percentage of SEC enforcement actions filed as follow-on actions declined significantly in fiscal year 2015,⁶¹ but so did the percentage of contested cases sent in-house by the SEC. In fiscal year 2015, the SEC used its home court for 28% of its contested cases, compared with 43% in 2014.⁶²

Fourth, the bulk of the post-Dodd-Frank increase in administrative enforcement by the SEC is explained by an uptick in cases that are filed as settled. This is true generally⁶³ and with respect to the high

55 See, e.g., Eaglesham, *supra* note 11 (quoting Joseph Grundfest, Professor, Stanford Law School, for the proposition that by shifting to in-house enforcement the SEC “is not only increasing its chances of winning but giving itself greater control over the future evolution of legal doctrine”).

56 Ceresney Keynote Speech, *supra* note 27.

57 Wander, *supra* note 34.

58 Henry Engler, SEC’s “Administrative Proceedings” Enforcements Dwarf Court Cases in 2015, REUTERS (July 9, 2015), <http://blogs.reuters.com/financial-regulatory-forum/2015/07/09/secs-administrative-proceedings-enforcements-dwarf-court-cases-in-2015/>.

59 U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 12.

60 *Id.* at 13.

61 Ed Beeson, SEC Enforcement Surged to Record High in Fiscal Year 2015, LAW360 (Oct. 22, 2015, 3:13 PM), <http://www.law360.com/articles/717586/sec-enforcement-surged-to-record-high-in-fiscal-year-2015>.

62 Jean Eaglesham, SEC Trims Use of Its In-House Judges, WALL ST. J. (Oct. 11, 2015, 9:00 PM), <http://www.wsj.com/articles/sec-trims-use-of-in-house-judges-1444611604>.

63 Ceresney Keynote Speech, *supra* note 27 (“The vast majority of the uptick in the numbers of actions we have brought as administrative proceedings are settled actions.”).

priority subject areas of insider trading and FCPA violations.⁶⁴ Indeed, in the first half of fiscal year 2016, 98% of public company and related subsidiary defendants resolved their SEC enforcement actions on the same day they were initiated, compared with 78% in 2010.⁶⁵ Resolving actions by filing them on the SEC's home turf as settled yields clear advantages for respondents. The dual risks that a federal judge will reject the settlement or that a downstream contempt proceeding will stem from a federal injunction are negated, and there is a public relations benefit arising from the perception that an administrative settlement is a less severe sanction than the settlement of federal litigation.⁶⁶ The SEC also benefits from enhanced efficiency⁶⁷ and negation of the risk that a federal judge will demand changes to negotiated settlements, dismiss charges, or otherwise limit claims. Moreover, the imposition of a cease-and-desist order in an FCPA administrative proceeding requires only that the SEC establish a likelihood that respondent will violate federal securities laws, as opposed to the more stringent "reasonable likelihood" standard applicable to issuance of an injunction.⁶⁸ It is no surprise that "the settled action is the SEC's preferred technique in enforcement matters,"⁶⁹ and during the period 2002–2014 the SEC's settlement rate remained constant at about 98%.⁷⁰

While the raw numbers of administrative proceedings may overstate the case, the SEC has undeniably shifted enforcement to its home court, and it has done so in areas it has designated as high priority for enforcement.⁷¹ The Division has almost unlimited discretion

64 Of the six insider trading cases filed by the SEC in the first half of fiscal year 2015, five settled on the same day they were filed, whereas only five of the eleven cases commenced in federal court during the same period settled on the same day. Gilley et al., *supra* note 2. Similarly, all of the FCPA cases commenced by the SEC as administrative proceedings in 2013, 2014, and the first half of 2015 settled on the same day they were filed. *Id.*

65 Stephen Choi et al., *supra* note 6, at 5.

66 COVINGTON & BURLING, LLP, *supra* note 45.

67 See *Ceresney Remarks*, *supra* note 19 ("For settled matters, we often, but not always, choose to file in an administrative forum, largely because of efficiency.").

68 Yannett et al., *supra* note 42, at 3–5.

69 Cox, *supra* note 24, at 6. See also U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 24 ("Historically, the overwhelming majority of SEC enforcement actions have been settled prior to filing.").

70 Priyah Kaul, Note, *Admit or Deny: A Call for Reform of the SEC's "Neither-Admit-Nor-Deny" Policy*, 48 U. MICH. J.L. REFORM 535, 536 (2015).

71 *But cf.* Stephen J. Choi & Adam C. Pritchard, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment 1* (NYU Ctr. For Law, Econ. and Org., Working Paper No. 16-10, 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2737105 ("[I]t does appear that the SEC is using administrative proceedings to expand its enforcement efforts against public companies. Post-Dodd Frank, the SEC has shifted toward costlier-to-prosecute actions that may reflect weaker and/or less salient cases relative to pre-Dodd

to choose where to litigate a case, subject to approval by the Commission.⁷² No provision of Dodd-Frank, the federal securities laws, or the SEC's Rules of Practice identifies the circumstances in which the SEC "must, should or may select one forum or the other."⁷³ How does the SEC exercise its discretion? Prior to 2015 the SEC provided few public clues about its choice of venue. In May 2015 the Division provided the first formal guidance when its staff issued a four-page memorandum that outlines the Division's approach to forum selection in contested matters.⁷⁴

The widely criticized memorandum, which was not issued by the Commission and thus does not represent Commission-level policy,⁷⁵ identifies four broad factors that the Division may consider in deciding whether to pursue an enforcement action in federal district court or as an administrative proceeding before an SEC ALJ. The four factors are: (1) the "availability of the desired claims, legal theories, and forms of relief in each forum"; (2) whether "any charged party is a registered entity or an individual associated with a registered entity"; (3) the "cost-, resource-, and time-effectiveness of litigation in each forum"; and (4) the "fair, consistent, and effective resolution of securities law issues and matters."⁷⁶

For multiple reasons the 2015 memorandum is of limited guidance to parties seeking clarity about the choice of forum. The Divi-

Frank administrative proceedings."). *See also* Shaswat Das & Samuel Wolff, *The Trump Administration's Impact on Financial Regulation*, LAW360 (Nov. 23, 2016, 9:58 AM), <http://www.law360.com/articles/865105/the-trump-administration-s-impact-on-financial-regulation> (speculating that use of SEC administrative enforcement will decline during the Trump presidency).

⁷² *Ceresney Keynote Speech*, *supra* note 27 (noting that "there is no rigid formula dictating the choice of appropriate forum" and that the Division "recommends a choice of forum in each case but the Division's recommendations are in all cases subject to review and approval by the Commission").

⁷³ Sarah S. Gold & Richard L. Spinogatti, *Constitutional Challenges to SEC Administrative Proceedings*, N.Y. L.J. (Apr. 8, 2015), <http://www.newyorklawjournal.com/id=1202722840733/Constitutional-Challenges-to-SEC-Administrative-Proceedings?slreturn=20150827215456>. *Accord* *Tilton v. SEC*, 824 F.3d 276, 278 (2d Cir. 2016) (observing that the choice of forum "belongs to the SEC without express statutory constraint").

⁷⁴ SEC, DIVISION OF ENFORCEMENT, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS (May 8, 2015) [hereinafter, *SEC Approach*], <https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf>. The SEC's guidance does not apply in settled enforcement actions. Randall J. Fons, *Administrative Proceedings vs. Federal Court: The SEC Provides Limited Transparency into Its Choice of Forum*, MORRISON & FOERSTER, LLP 1 n.1 (May 11, 2015), <http://www.mofo.com/~media/Files/ClientAlert/2015/05/150511SECChoiceofForum.pdf>.

⁷⁵ Cox, *supra* note 24, at 4.

⁷⁶ *SEC Approach*, *supra* note 74.

sion has indicated that the foregoing factors are not exhaustive, some or all of them may be considered in a particular instance, and a single factor may be dispositive.⁷⁷ Accordingly, the document establishes no fundamental limitations on the SEC's exercise of discretion.⁷⁸ Professor Joseph Grundfest noted the plasticity of the four factors and concluded that "the Commission could, as a practical matter, bring many cases in either the administrative or federal forum while citing the same four factors as support for its decision."⁷⁹

The memorandum has sparked some controversy on additional grounds. The fourth factor, which refers to the Commission's "expertise" in securities matters,⁸⁰ is a clear allusion to the SEC's expectation that its rulings interpreting the federal securities laws are entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*⁸¹ The Supreme Court held in *Chevron* that courts must defer to reasonable agency interpretations of ambiguous statutes,⁸² and the post-Dodd-Frank SEC intends to take full advantage of *Chevron* by commencing enforcement actions as administrative proceedings which result in in-house rulings interpreting the federal securities laws. Public statements by the Division's Director have confirmed this intention.⁸³

77 See *Ceresney Keynote Speech*, *supra* note 27 (explaining the new guidance); Thomas A. Hanusik, *What's Missing from the SEC's Forum Selection Guidance*, LAW360 (May 21, 2015, 10:34 AM), <http://www.crowell.com/files/Whats-Missing-From-The-SECs-Forum-Selection-Guidance.pdf> (describing the factors as non-exhaustive, non-mandatory, and un-weighted); Cox, *supra* note 24, at 9 ("[T]he listing of some factors doesn't exclude other factors which aren't listed. So the actual factors that matter most in your case might not appear in this guidance at all.")

78 See, e.g., LATHAM & WATKINS, LLP, *Client Alert: SEC Enforcement Division Issues Guidance on Venue Selection*, (May 18, 2015), <https://www.lw.com/thoughtleadership/lw-sec-guidance-choice-of-venue> ("The Division's Guidance does not appear to constrain meaningfully the scope of the Division's discretion in seeking—or the full Commission's prerogative in deciding upon—a particular venue."); Fons, *supra* note 74, at 1 ("The guidance, however, ultimately provides the Division with virtually complete discretion in choosing the playing field that will be most advantageous to its case and to its view of the 'proper development of the law.'"); Thomas O. Gorman, *SEC Publishes a Memo on Forum Selection*, SEC ACTIONS (May 10, 2015, 7:48 PM), <http://www.secactions.com/sec-publishes-a-memo-on-forum-selection/> ("[T]his memorandum misses the mark. It offers virtually no insight into what can only be viewed as a 'black box' process used by the agency to make these critical decisions.")

79 Joseph A. Grundfest, *Fair or Foul? SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 13–14 (Rock Ctr. for Corp. Governance, Working Paper No. 212, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2695258.

80 *SEC Approach*, *supra* note 74.

81 467 U.S. 837 (1984).

82 *Id.* at 842–43.

83 See, e.g., *Ceresney Keynote Speech*, *supra* note 27 ("If a contested matter is likely to raise unsettled and complex legal issues under the federal securities laws, or interpretation of the

B. *The CFTC Follows the Leader*

The narrative of the CFTC's use of administrative proceedings differs in important respects from that of the SEC. From its inception in the mid-1970s to 1992, the CFTC was authorized to impose civil penalties for violations of the Commodity Exchange Act ("CEA")⁸⁴ through administrative proceedings and to commence proceedings in federal court to enjoin violations.⁸⁵ But it was not until the CEA was amended by the Futures Trading Practices Act of 1992⁸⁶ and federal courts were authorized to impose civil penalties⁸⁷ that the CFTC had an effective choice of forum. Historically, the CFTC was significantly more likely to choose an administrative forum than a federal one. During the 1990s, for example, the CFTC filed more administrative actions than district court actions every year, with the annual percentage ranging between 55 and 80% of the CFTC's filings.⁸⁸ Thereafter, the CFTC abandoned the use of contested administrative proceedings. Prior to 2016, the last contested enforcement case filed before a CFTC ALJ was in 2001.⁸⁹ In late 2014 the CFTC reversed course again when it announced its intent to follow the SEC's lead and move a portion of its contested enforcement docket in-house.⁹⁰

What factors explain the CFTC's shifting strategy? The CFTC's Division of Enforcement ("CFTC Division") has never publicly explained why it abandoned contested administrative proceedings in

Commission's rules, it may make sense to file the case as an administrative proceeding so a Commission decision on the issue, subject to appellate review in the federal courts, may facilitate development of the law." See also William F. Johnson, *Is it Time to Reconsider "Chevron" Deference for SEC Proceedings?*, N.Y. L.J. (July 2, 2015) ("The SEC has made clear that in certain cases it specifically chooses an administrative forum to influence the development of the law.").

84 7 U.S.C. §§ 1-27 (1992).

85 Dan M. Berkovitz, *The Resurrection of CFTC Administrative Enforcement Proceedings: Efficient Justice or a Biased Forum?*, 35 FUTURES & DERIVATIVES L. REP. 2, 5-7 (Mar. 2015), https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/the-resurrection-of-cftc-administrative-enforcement-proceedings.pdf.

86 Pub. L. 102-546, 106 Stat. 3590 (1992).

87 *Id.* at § 221.

88 Geoffrey F. Aronow, *Back to the Future: The Use of Administrative Proceedings for Enforcement at the CFTC and SEC*, 35 FUTURES AND DERIVATIVES L. REP. 1-2 (Jan./Feb. 2015), http://www.sidley.com/~media/publications/fdlr_aa_aronow.pdf.

89 Berkovitz, *supra* note 85.

90 See Hoover, *supra* note 7 ("CFTC Enforcement Director Aitan Goelman said the agency will 'very soon' follow the SEC's shift to litigating enforcement actions in-house . . ."); Stephanie Russell-Kraft, *Cash-Strapped CFTC Faces Troubled Return to Admin Court*, LAW360 (Nov. 14, 2014, 3:28 PM), <http://www.law360.com/articles/595182/cash-strapped-cftc-faces-troubled-return-to-admin-court> (reporting that the CFTC would soon bring enforcement actions in administrative forum).

2001, but it is widely believed that its almost decade-long losing streak before one of its own ALJs prompted it to throw in the towel.⁹¹ The CFTC's late-2014 announcement that it plans to resume administrative enforcement appears to be primarily a function of the agency's limited resources. While Dodd-Frank greatly expanded the CFTC's responsibilities, Congress has failed to provide the agency with the resources it requires to fulfill its mandate.⁹² In 2015 the CFTC Division had fewer staff than it did in 2002, when the agency's responsibilities did not include over-the-counter foreign currency transactions or the \$400 trillion⁹³ swaps market.⁹⁴ The CFTC's enforcement staff and budget are both much smaller than their counterparts at the SEC—even though the futures, options, and swaps markets regulated by the CFTC are much larger than the securities market regulated by the SEC⁹⁵—and the CFTC's budget remained flat for fiscal year 2016.⁹⁶

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- 91 Todd Mullins & Chris McEachran, *Adjudication of FERC Enforcement Cases: "See You in Court?"*, 36 ENERGY L.J. 261, 289 (2015) ("The CFTC did not have the best success rate before its administrative courts, and has not brought an enforcement action administratively in over ten years . . ."); Berkovitz, *supra* note 85; Ben James, *Outgoing CFTC Judge Blasts Colleague, Alleges Bias*, LAW360 (Oct. 15, 2010, 6:54 PM), <http://www.law360.com/articles/201915/outgoing-cftc-judge-blasts-colleague-alleges-bias> (recounting prior report that in nearly 180 cases during an eight-year period, CFTC ALJ Bruce Levine ruled against investors every time, except in a handful of cases in which defunct firms defaulted).
- 92 See, e.g., Sharon Bowen, Commissioner, CFTC, Speech Before the Futures Industry Association Expo 2014 (Nov. 5, 2014), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opabowen-1> ("[T]he Commission continues to face a crisis that has lasted for years: chronic under-funding compared to the scope of its mission. . . . Our budget is insufficient, and the Commission and staff consistently have to make difficult choices about how to allocate scarce resources amongst our many regulatory priorities."); Ed Beeson, *CFTC's Paltry Budget Spurs Quick End to Forex Probe*, LAW360 (Nov. 12, 2014, 7:30 PM), <http://www.law360.com/articles/595407/cftc-s-paltry-budget-spurs-quick-end-to-forex-probe> (reporting that the budget crunch at the CFTC helped force the agency's hand in quickly settling with five banks concerning the manipulation of foreign currency exchange rates).
- 93 Timothy G. Massad, Chairman, Commodity Futures Trading Comm'n, Testimony Before U.S. Senate Comm. on Agric., Nutrition & Forestry (May 14, 2015), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-22> (stating that the U.S. swaps market exceeds \$400 trillion, measured by notional amount).
- 94 Sung-Hee Suh & Amanda Jawad, *The ABCs of CFTC Enforcement Actions*, 46 BLOOMBERG BNA SEC. REG. & L. REP. 1447 (Jul. 28, 2014) (explaining the scope of CFTC jurisdiction); Paul M. Architzel et al., *CFTC Enforcement Alert: 2014 CFTC Enforcement Year-in-Review, and a Look Forward*, WILMER CUTLER PICKERING HALE & DORR, LLP (Feb. 10, 2015), https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/WH_Publications/Client_Alert_PDFs/2014-cftc-enforcement-year-in-review.pdf.
- 95 See Zach Brez & Jon Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, 44 BLOOMBERG BNA SEC. REG. & L. REP. 1209 (2012) ("The CFTC has received only a fraction of the resources that have been provided to the SEC.").

This unresolved resource issue helps explain the low level of enforcement activity at the CFTC⁹⁷—during the period 2000–2013 the agency initiated a mere fifty-seven enforcement actions per year on average,⁹⁸ and in fiscal year 2015 the number increased only to sixty-nine.⁹⁹ The resource deficit also is driving the CFTC’s enforcement shift. The CFTC’s Division Director has stated that the overwhelming reason for the move to administrative enforcement is the agency’s lack of resources and “bandwidth for discovery-intense litigation.”¹⁰⁰ Administrative enforcement typically is much cheaper for an agency than federal litigation.¹⁰¹ But it is quite likely that the CFTC also has been encouraged by the SEC’s excellent track record on its home court.¹⁰²

More than a decade after the CFTC abandoned contested administrative enforcement it also ceased to employ ALJs. The agency last employed an ALJ in 2012.¹⁰³ The CFTC has stated that when it resumes in-house enforcement it will use ALJs borrowed from other agencies.¹⁰⁴ Initially, it appeared likely that the CFTC would borrow ALJs from the SEC, at least in part because those judges are familiar with the fraud standard provided to the CFTC in Dodd-Frank—a standard very similar to the one used in SEC enforcement proceed-

96 Daniel Siegel, *CFTC Chair Slams Congress for Denying Budget Bump*, LAW360 (Aug. 17, 2015, 8:24 PM), <http://www.law360.com/articles/740471/cftc-chair-slams-congress-for-denying-budget-bump>.

97 See, e.g., John Kennedy, *Slim CFTC Staffing Delays Enforcement Reviews, Report Says*, LAW360 (Aug. 17, 2015, 9:43 PM), <http://www.law360.com/articles/691617/slim-cftc-staffing-delays-enforcement-reviews-report-says> (reporting that inadequate staffing has hampered CFTC enforcement reviews of derivatives exchanges).

98 Gregory S. Kaufman & Lillian A. Forero, *Return to Normal? Dodd-Frank Authority Has Not Resulted in More Enforcement Actions . . . Yet!*, 47 BLOOMBERG BNA SEC. REG. & L. REP. 605 (Mar. 23, 2015).

99 Ed Beeson, *CFTC Enforcement Earns New Stripe After Besting SEC Haul*, LAW360 (Nov. 6, 2015, 10:43 AM), <http://www.law360.com/articles/724227/cftc-enforcement-earns-new-stripe-after-besting-sec-haul>.

100 Hoover, *supra* note 7; Stephanie Russell-Kraft, *Cash-Strapped CFTC Faces Troubled Return to Admin Court*, LAW360 (Nov. 14, 2014, 3:28 PM), <http://www.law360.com/articles/595182/cash-strapped-cftc-faces-troubled-return-to-admin-court>.

101 Jean Eaglesham, *CFTC Turns Toward Administrative Judges*, WALL ST. J. (Nov. 9, 2014, 5:49 PM), <http://www.wsj.com/articles/cftc-turns-toward-administrative-judges-1415573398>.

102 Kaufman & Forero, *supra* note 98 (“How could the CFTC not be attracted to a process that has seen the SEC win 219 decisions before its ALJs?”).

103 See Stephanie Russell-Kraft, *Cash-Strapped CFTC Faces Troubled Return to Admin Court*, LAW360 (Nov. 14, 2014, 3:28 PM), <http://www.law360.com/articles/595182/cash-strapped-cftc-faces-troubled-return-to-admin-court> (noting that, unlike in the 1990s, the CFTC no longer employs ALJs).

104 *Id.* (“[T]he CFTC will be ‘renting’ or ‘borrowing’ ALJs from other agencies that have ‘extra bandwidth.’”).

ings.¹⁰⁵ The CFTC would not have been the only federal agency to borrow SEC ALJs. The Consumer Financial Protection Bureau (“CFPB”)—another product of Dodd-Frank—has the option of commencing enforcement actions in state or federal court or as administrative proceedings before an ALJ,¹⁰⁶ but it has no ALJs of its own and thus it has borrowed from the SEC.¹⁰⁷

However, by late 2015 the CFTC was stymied. It had not been able to borrow SEC ALJs, as a collateral consequence of constitutional attacks on the SEC’s enforcement program, and thus the CFTC had not resumed administrative proceedings.¹⁰⁸ The situation remains static in 2016.

C. Home Court Advantage?

The SEC has enjoyed its home court advantage. It has been considerably more successful in administrative proceedings than in federal court. During the period October 2010 to September 2015, the SEC prevailed against 86% of respondents in contested cases in administrative proceedings,¹⁰⁹ whereas it had a much lower success rate of 70% in federal court during the same period.¹¹⁰ The SEC’s in-

105 Kaufman & Forero, *supra* note 98; Zach Brez & Jon Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, 44 BLOOMBERG BNA SEC. REG. & L. REP. 1209 (June 18, 2012), (“The Dodd-Frank Act significantly strengthened the CFTC’s authority to prohibit fraudulent and manipulative behavior by adopting an approach similar to Rule 10b-5.”).

106 LATHAM & WATKINS, LLP, *Client Alert White Paper No. 1782: CFPB Enforcement by the Numbers* (Dec. 22, 2014), <https://www.lw.com/thoughtLeadership/lw-cfpb-enforcement-by-numbers>.

107 Jon Eisenberg, *We’ve Only Just Begun—Lessons from the CFPB’s First 35 Enforcement Cases*, K&L GATES, LLP (Mar. 5, 2014), <http://www.klgates.com/weve-only-just-begun-lessons-from-the-cfpbs-first-35-enforcement-cases-03-05-2014/> (“[T]he CFPB will request the SEC to assign one of the three SEC administrative law judges to preside over the CFPB administrative proceeding.”).

108 Ed Beeson, *CFTC Enforcement Chief Bemoans Lack of In-House Judges*, LAW360 (Oct. 16, 2015, 8:10 PM), <http://www.law360.com/articles/715444/cftc-enforcement-chief-bemoans-lack-of-in-house-judges> (“It became much more difficult to source ALJs from other agencies because [of] all the sturm und drang around the SEC’s program”) (quoting Aitan Goelman, Director of Enforcement, CFTC).

109 Eaglesham, *supra* note 8. *But cf.* Jean Eaglesham, *SEC Judges are Finding Against Agency More Often Lately*, WALL ST. J. (Nov. 22, 2015, 9:01 PM), <http://www.wsj.com/articles/sec-judges-are-finding-more-often-for-agency-lately-1448243785> (reporting that the SEC’s success rate in APs declined in 2015 to 67%, with some cases still undecided); Joshua M. Newville & Samantha Springer, *Who Wins in Administrative Proceedings?*, NAT’L L. REV. (Aug. 8, 2016), <http://www.natlawreview.com/article/who-wins-sec-administrative-proceedings> (“Our analysis of ALJ opinions from October 2014 through the present reveals the SEC had only an 81% win rate in contested ALJ matters, while it prevailed in 91% of federal court trials over the same period.”).

110 Eaglesham, *supra* note 8.

house success rate is not purely a recent phenomenon—the SEC prevailed in fifty-eight out of sixty-two administrative proceedings conducted during the period 1983–1988.¹¹¹ The recent statistics concerning appeals also are glaring. As noted, the first level of appeal in an SEC administrative proceeding is to the SEC Commissioners. They found in the agency’s favor in 95% of appeals during the period October 2010 to March 2015.¹¹²

The raw statistics set forth above overstate the case, in a couple of respects. First, the SEC records as a trial victory any case in which it secures a finding of liability on any claim against any respondent, even if it fails to secure such a finding with regard to the majority of claims.¹¹³ Second, many of the SEC’s victories occur in such routine matters as delisting proceedings.¹¹⁴ In calendar year 2014, SEC ALJs issued 183 initial decisions, 119 of which terminated the registration of public companies for failure to file periodic reports. The SEC prevailed in all 119 of these APs,¹¹⁵ which means that 65% of the SEC’s success rate in 2014 APs is attributable to its success in routine delisting actions.

Notwithstanding the foregoing, it is undeniable that the SEC enjoys considerably more success on its home court than it does in federal court.¹¹⁶ The same cannot be said of the CFTC. As noted, since the early 2000s the CFTC has filed all of its contested enforcement cases in federal court, and one common explanation is that the Commission had become discouraged by its long losing streak in

111 Comm. on Fed. Reg. of Sec., *Report of Task Force on the SEC Administrative Law Judge Process*, 47 BUS. LAW. 1731, 1734 (1992) [hereinafter, *Task Force Report*].

112 Eaglesham, *supra* note 11. See also Adam M. Wolper & Heidi VonderHeide, *The SEC’s Increased Use of Administrative Proceedings in Enforcement Actions: Background, Controversies, and Future Outlook*, 17 J. INVESTMENT COMPLIANCE 17, 19 (2016) (“ALJ findings against respondents who appeal to the Commission are rarely reversed; in fact, respondents are far more likely to see their sanctions or penalties *increased* on appeal, rather than reduced.”). *But cf. Ceresney Remarks*, *supra* note 19, at 3 (“I would challenge anyone to identify a case in which an ALJ erroneously ruled for us where the Commission did not reverse the decision.”).

113 See *Ceresney Keynote Speech*, *supra* note 27; Davison et al., *supra* note 20, at 104 n.4. See also Jean Eaglesham, *Senior SEC Official Calls Claims of Advantage at In-House Tribunal ‘Garbage’*, WALL ST. J. (Feb. 19, 2016, 5:52 PM), <http://www.wsj.com/articles/senior-sec-official-calls-claims-of-advantage-at-in-house-tribunal-garbage-1455922322> (noting that in many in-house cases that are not dismissed, the SEC fails to obtain all of the remedies that it seeks).

114 Davison et al., *supra* note 20, at 104.

115 U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 13.

116 See Aronow, *supra* note 88 (“[I]t would be hard to deny that, generally speaking, there is a significant ‘home-court advantage’ to the administrative route.”).

front of one of its own ALJs.¹¹⁷ Additional evidence suggests that the CFTC has not enjoyed home court success. A 1995 study by the General Accounting Office found that the CFTC ruled on forty-eight appeals of ALJ enforcement decisions during the period 1989–1993, modified sanctions in almost 40% of those cases, and reduced sanctions in almost 80% of the cases in which modifications occurred.¹¹⁸ Finally, one review of the CFTC’s handling of complex market manipulation cases in the 1970s and 1980s found that the record does not support the view that the agency enjoys any home court advantage when bringing such cases.¹¹⁹

D. SEC and CFTC Procedures

In order to understand the constitutional arguments concerning the use of administrative proceedings by the SEC and CFTC it is essential to first understand the process used by those two agencies. The next part of this Article examines the administrative process. As will be seen, the agencies enjoy a number of procedural advantages. The SEC uses its superior position as leverage during settlement discussions with potential respondents.¹²⁰

1. SEC

SEC administrative proceedings are governed by the SEC’s Rules of Practice (“SEC RoP”),¹²¹ which prior to 2016 had not been amended since 2006¹²²—four years before Dodd-Frank greatly expanded the

117 See text accompanying notes 88–91 *supra*.

118 U.S. GENERAL ACCOUNTING OFF., ADMIN. LAW JUDGES: COMPARISON OF SEC AND CFTC PROGRAMS 29, Report No. GGD-96-27 (Nov. 1995) [hereinafter, *GAO Report*], <http://www.gao.gov/assets/230/221858.pdf>.

119 Berkovitz, *supra* note 85, at 8.

120 See, e.g., Peter Hardy, Abe Rein & Carolyn Kendall, *SEC ALJs: An Enforcement Fast-Track is Hitting the Constitutional Skids*, WHITE COLLAR CRIME PROF BLOG (Aug. 13, 2015), http://lawprofessors.typepad.com/whitecollarcrime_blog/2015/08/sec-aljs-an-enforcement-fast-track-is-hitting-the-constitutional-skids.html (“Anecdotal reports also strongly suggest that the SEC has invoked its perceived advantages before ALJs during settlement negotiations with potential respondents.”); Stephanie Russell-Kraft, *Ceresney Defends In-House Courts to Skeptical Lawmakers*, LAW360 (Mar. 19, 2015, 3:47 PM), <http://www.law360.com/articles/631232/ceresney-defends-in-house-courts-to-skeptical-lawmakers> (“[T]he SEC has threatened defendants with administrative proceedings before settling.”).

121 *Jarkesy v. SEC*, 803 F.3d 9, 12 (D.C. Cir. 2015). The SEC RoP are codified at 17 C.F.R. §§ 201.100 *et seq.* (2006).

122 See Securities and Exchange Commission, Adoption of Amendments to the Rules of Practice and Related Provisions and Delegations of the Authority of the Commission, Release

SEC's authority to use an administrative forum. Neither the Federal Rules of Civil Procedure ("FRCP")¹²³ nor the Federal Rules of Evidence ("FRE")¹²⁴ apply.

The SEC administrative procedures outlined below governed APs initiated on or before September 27, 2016. Amendments to the SEC RoP took effect the next day, and they made incremental changes to the process, as described in Part IV.D below. The SEC commences an administrative proceeding with an Order Instituting Proceedings ("OIP"), which contains the Division's allegations against the respondent(s) and serves as the charging document. A respondent has thirty days from service of the OIP to file an answer.

There is no provision in the SEC's RoP for making a motion to dismiss, asserting a counterclaim, or moving for summary judgment. The closest analogue to a summary judgment is a motion for summary disposition under Rule 250(b).¹²⁵ Either side may make such a motion, but in general the facts alleged in the pleadings of the party against whom the motion is made "shall be taken as true"¹²⁶ and the comment to Rule 250 suggests that summary disposition prior to hearing would rarely be appropriate.¹²⁷ The SEC disfavors summary disposition even where the sole question presented is legal, rather than factual.¹²⁸ In practice, respondents' motions are very rarely granted.¹²⁹ Summary disposition in favor of the Division is often granted in uncontested proceedings or in a follow-on action by the Division seeking such relief as an industry bar, after a respondent has already been enjoined or convicted.¹³⁰ Apart from a Rule 250 motion,

Nos. 34-52846, File No. S7-05-05 (Nov. 29, 2005), <https://www.sec.gov/rules/final/34-52846.pdf> (indicating effective date of Jan. 4, 2006).

123 Davison et al., *supra* note 20, at 109 ("The Federal Rules of Civil Procedure do not apply in SEC administrative hearings.").

124 *Id.* at 110 ("The Federal Rules of Evidence also do not apply in SEC administrative hearings.").

125 SEC Rules of Practice, 17 C.F.R. § 201.250(b) (2016).

126 *Id.* at § 201.250.

127 SEC Rules of Practice, 60 Fed. Reg. 32,767, 32,768, cmt. (June 23, 1995) (codified as 17 C.F.R. 201.250).

128 DORFMAN & WINER, *supra* note 22, at § 19.04(12).

129 Theodore B. Olson, Comment Letter on Proposed Rule on Amendments to the Commission's Rules of Practice, 14, GIBSON, DUNN & CRUTCHER, LLP (Dec. 4, 2015), <http://www.sec.gov/comments/s7-18-15/s71815-8.pdf> (noting that since 1995 ALJs have granted only a handful of motions for summary disposition filed by respondents); Luke T. Cadigan, *Litigating an SEC Administrative Proceeding*, 58 BOSTON BAR J., Winter 2014, <http://bostonbarjournal.com/2014/01/07/litigating-an-sec-administrative-proceeding/>

130 Cadigan, *supra* note 129.

there is very little other motion practice in SEC administrative proceedings.¹³¹

The SEC RoP provide that an administrative proceeding can be heard by the Commission or by a hearing officer duly designated by the Commission.¹³² In virtually all cases the OIP specifies that the case is assigned to an SEC ALJ.¹³³ There is no right to a jury trial.¹³⁴ The 2003 amendments to the SEC RoP require the OIP to state whether the SEC ALJ has 120, 210, or 300 days from the OIP service date in which to complete his or her initial decision. There are no other options. The selection of one of the three options is based on the “nature, complexity, and urgency of the subject matter.”¹³⁵ The majority of contested SEC administrative proceedings are sufficiently complex to warrant the 300-day timeline.¹³⁶ When that timeline does apply, the ALJ is required by the SEC RoP to schedule the hearing for a date approximately four months from service of the OIP. If the timeline is 210 days then the hearing must be scheduled for a date approximately two and a half months from service of the OIP, and if it is 120 days then the hearing must occur within approximately one month from service.¹³⁷

There is very limited discovery during an SEC administrative proceeding. In general, neither interrogatories nor discovery depositions are allowed.¹³⁸ This is true even in complex cases where the Division may have conducted dozens of on-the-record examinations of

131 *Id.* (“[M]ost motions are disfavored or not even permitted . . .”). One exception is that a respondent may file a motion for a more definite statement with an answer. SEC Rules of Practice, 17 C.F.R. 201.220(d) (2016).

132 SEC Rules of Practice, 17 C.F.R. 201.100 (2016) (specifying procedures when an ALJ has been selected as the hearing officer).

133 DORFMAN & WINER, *supra* note 22, at § 19.04(1).

134 *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1298 (N.D. Ga. 2015).

135 SEC Rules of Practice, 17 C.F.R. 201.360(a)(2) (2016).

136 Cadigan, *supra* note 129. One review found that the SEC has largely reserved the 120-day track for proceedings designed to suspend or revoke the registration of stock where the issuer had failed to file annual or periodic reports, whereas the 210-day track has been utilized by the SEC for follow-on APs to sanction brokers or investment advisers previously found liable for securities laws violations. See Christian J. Mixter, *Defending an SEC Administrative Proceeding*, ALI-ABA BUSINESS L. COURSE MATERIALS J. 51, 53 (June 2008), http://files.ali-aba.org/thumbs/datastorage/lacidoirep/articles/CMJ0806-Mixter_thumb.pdf.

137 SEC Rules of Practice, 17 C.F.R. 201.360(a)(2) (2016).

138 DORFMAN & WINER, *supra* note 22, at § 19.04(6) (2014); SEC Rules of Practice, 60 Fed. Reg. 32,738, 32,765, cmt. (June 23, 1995) (codified as 17 C.F.R. § 201.233) (depositions “are not allowed for purposes of discovery”). Rule 221(c) of the SEC RoP, which concerns subjects to be discussed at the prehearing conference, suggests the possibility that written interrogatories could be authorized, but this is not a matter of right. U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 59 n.74.

fact witnesses before the OIP was filed. Depositions upon oral or written examination may be allowed after the OIP has been filed if a party believes the witness will be unable to attend or testify at the hearing,¹³⁹ but the ALJ retains discretion to deny such requests. ALJs seldom allow depositions.¹⁴⁰

The scope of permissible discovery is primarily defined by Rule 230(d), which requires the Division to commence turning over its investigative files to respondents within seven days of service of the OIP.¹⁴¹ The Division may withhold four categories of documents, including documents protected by a privilege or by the attorney work product doctrine and documents disclosing the identities of confidential sources.¹⁴² Pursuant to *Brady v. Maryland*,¹⁴³ which the SEC has chosen to apply in administrative proceedings, the Division may not withhold documents containing material exculpatory evidence. In addition, Rule 232 provides for the pre-hearing production of documents pursuant to subpoena.¹⁴⁴ A party may serve subpoenas for documents on anyone, including a third-party or the SEC. The SEC RoP require issuance unless the subpoena is “unreasonable, oppressive, excessive in scope, or unduly burdensome,”¹⁴⁵ but in practice ALJs often decline to issue subpoenas or choose to significantly narrow their scope.¹⁴⁶

As noted, the FRE do not apply to SEC administrative proceedings. The FRE serve as a general guide for the admission of evidence,¹⁴⁷ but SEC ALJs are expected to admit all evidence which “can conceivably throw any light upon the controversy.”¹⁴⁸ Hearsay is ad-

139 SEC Rules of Practice, 17 C.F.R. § 201.233 (2016).

140 Arthur F. Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 CATH. U. L. REV. 215, 253 (1980).

141 SEC Rules of Practice, 60 C.F.R. §201.230(d) (2016).

142 *Id.* at § 201.230(b); SEC Rules of Practice, 60 Fed. Reg. 32,738, 32,762, cmt. (b), (1995).

143 373 U.S. 83, 91 (1963).

144 SEC Rules of Practice, 17 C.F.R. § 201.232 (2016).

145 *Id.*

146 See U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 20 (“[T]he rigorous deadlines for completion of a proceeding often result in ALJ reluctance to delay a hearing by approving the issuance of subpoenas.”); Ryan S. Stippich, *Constitutional and Strategic Considerations Regarding SEC Enforcement Actions Following Dodd-Frank*, ASPATORE (Apr. 2016), 2016 WL 2989433, at *6 (“[S]ubpoenas are often limited strictly to information limited by the allegations in the charging document. It is common for ALJs to limit the scope of document subpoenas on their own accord, even without objection by the Division or the subpoenaed party.”). *But see* DORFMAN & WINER, *supra* note 22, at § 19.04(10) (describing issuance of subpoenas by SEC ALJs as “liberal”).

147 GAO Report, *supra* note 118, at 19.

148 Hill v. SEC, 114 F. Supp. 3d 1297, 1302 (N.D. Ga. 2015) (citations and quotations omitted), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016).

missible and can provide the basis for a finding that a securities violation has occurred.¹⁴⁹ ALJs are required to exclude all evidence that is “irrelevant, immaterial or unduly repetitious,”¹⁵⁰ but this restriction has no practical significance—ALJs “tend to admit the vast majority of evidence offered by the parties,”¹⁵¹ with most evidentiary battles concerning credibility and weight, rather than admissibility.¹⁵²

The ALJ issues the initial decision on the merits and the requested relief approximately two months after post-hearing briefing is completed.¹⁵³ Any party may appeal the initial decision. The first level of appeal is to the SEC itself,¹⁵⁴ and this is known formally as a petition for Commission review. The Commission has the discretion to decline to grant most petitions for review,¹⁵⁵ but apparently it has never denied a timely petition.¹⁵⁶ Alternatively, it can decide *sua sponte* to review an initial decision even if no party seeks review.¹⁵⁷ There is no statutorily prescribed standard for Commission review of ALJ decisions.¹⁵⁸ In practice, the Commission conducts a *de novo* review of both conclusions of law and findings of fact¹⁵⁹ and may accept or hear additional evidence.¹⁶⁰ Because the review is *de novo* the Commission may make its own credibility determinations.¹⁶¹ In short, under the APA, the SEC is omnipotent when it comes to ALJ decisions.¹⁶² The ALJ’s initial decision becomes final if no appeal has been filed, the

149 See, e.g., Guy P. Riordan, Securities Act Release Nos. 33-9085, 34-61153, 97 SEC Docket 1337, 1348 (Dec. 11, 2009); Scott Epstein, Exchange Release No. 34-59328, 95 SEC Docket 285, 295 (Jan. 30, 2009).

150 SEC Rules of Practice, 17 C.F.R. § 201.320 (2016).

151 Davison et al., *supra* note 20, at 110.

152 *Id.*

153 Cadigan, *supra* note 129.

154 See *Jarkesy v. SEC*, 803 F.3d 9, 12–13 (D.C. Cir. 2015) (explaining the SEC AP process).

155 SEC Rules of Practice § 201.411(b)(2) (2016) (stating that the Commission may decline all petitions for review other than those listed in § 201.411(b)(1)).

156 See *Raymond J. Lucia Cos., Inc.*, Admin. Proc. File No. 3-15006, Securities Exchange Act Rel. No. 75837, at 30 (Sept. 3, 2015), *pet. denied*, *Raymond J. Lucia Cos. v. SEC*, No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016) (“[W]e are unaware of any cases which the Commission has not granted a timely petition for review.”).

157 SEC Rules of Practice, 17 C.F.R. §§ 201.410, 201.411(c) (2016).

158 *GAO Report*, *supra* note 118, at 20.

159 DORFMAN & WINER, *supra* note 22, at § 19.06(2).

160 SEC Rules of Practice, 17 C.F.R. §§ 201.411(a), 201.452 (2016).

161 Davison et al., *supra* note 20, at 112. However, the SEC will accept the ALJ’s credibility finding, absent overwhelming evidence to the contrary. *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1298 (N.D. Ga. 2015).

162 James E. Moliterno, *The Administrative Judiciary’s Independence Myth*, 41 WAKE FOREST L. REV. 1191, 1225 (2006). In practice, however, the Commission typically does not second-guess credibility determinations by ALJs. See, e.g., Robert Thomas Clawson, Exchange Act Release No. 34-48143, 80 SEC Docket 1767, 1769 (July 9, 2003) (“We accept a fact finder’s credibility finding, absent overwhelming evidence to the contrary . . .”).

Commission has not ordered review on its own initiative, and the Commission has issued an order of finality.¹⁶³

The Commission alone possesses the authority to issue a final order.¹⁶⁴ When review by the Commission does occur it is not unduly delayed. For the six-month period ending March 31, 2016, the median age of initial decisions by ALJs was 385 days at the point of disposition by the Commission.¹⁶⁵ This represented a slight improvement from the 399 days for the comparable period in 2015.¹⁶⁶

Any respondent may appeal an adverse final order by the Commission to the Court of Appeals for the District of Columbia Circuit or for the circuit in which the respondent resides or has his or her principal place of business.¹⁶⁷ An initial appeal to the Commission is a prerequisite to a subsequent judicial appeal.¹⁶⁸ The Division cannot seek judicial review of an adverse ruling.¹⁶⁹ On appeal, the findings of fact by the Commission are conclusive if supported by substantial evidence.¹⁷⁰ This means that the findings need only be supported by evidence sufficient to support a reasonable fact-finder's decision.¹⁷¹ This is more than a scintilla but less than a preponderance.¹⁷² The standard is "extremely deferential,"¹⁷³ requires an appellate court to uphold the Commission's findings unless the evidence presented would compel a reasonable finder of fact to reach a contrary result,¹⁷⁴

163 SEC Rules of Practice, 17 C.F.R. § 201.360(d)(2) (2016).

164 *Jarkesy v. SEC*, 803 F.3d 9, 12–13 (D.C. Cir. 2015); *Bennett v. SEC*, 151 F. Supp. 3d 632, 641 (D. Md. 2015) (noting that the SEC alone possesses authority to issue a final order).

165 SECURITIES AND EXCHANGE COMMISSION, *Report on Administrative Proceedings for the Period October 1, 2015 through March 31, 2016*, Rel. No. 77733 (Apr. 27, 2016), <https://www.sec.gov/reportspubs/special-studies/34-77733.pdf>.

166 *Id.*

167 *See Jarkesy*, 803 F.3d at 13 (stating that according to the Exchange Act, review may be sought in the D.C. circuit, or the circuit court where defendant either resides or has a principal place of business); *Bebo v. SEC*, 799 F.3d 765, 768 (7th Cir. 2015); 15 U.S.C. § 78y(a)(1), 15 U.S.C. § 77i (2012).

168 SEC Rules of Practice, 17 C.F.R. § 201.410(e) (2006).

169 DORFMAN & WINER, *supra* note 22, at § 19.06(1).

170 15 U.S.C. § 80b-13(a) (2012); *Montford & Co., Inc. v. SEC*, 793 F.3d 76, 81 (D.C. Cir. 2015).

171 *Birkelbach v. SEC*, 751 F.3d 472, 478 (7th Cir. 2014).

172 *Gebhart v. SEC*, 595 F.3d 1034, 1043 (9th Cir. 2010).

173 *Id.* (internal quotation marks omitted). *See also* Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE (2013), http://www.hblr.org/wp-content/uploads/2013/11/Ryan_The-Equity-Fa%C3%A7ade-of-SEC-Disgorgement.pdf (describing appellate review of SEC administrative enforcement as limited and deferential). The appellate court's review is slightly less deferential where the Commission has reached a conclusion contrary to that of the ALJ. *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2015).

174 *Gebhart*, 595 F.3d at 1043.

and helps explain why successful appeals are rare.¹⁷⁵ The Commission's conclusions of law are reviewed *de novo*¹⁷⁶ and may be set aside only if they are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.¹⁷⁷ The penalties imposed by the Commission also are reviewed under an abuse of discretion standard.¹⁷⁸ The court of appeals has the option to remand for further factual development.¹⁷⁹

2. CFTC

The SEC's RoP have served as a model for other federal agencies, including the CFPB,¹⁸⁰ and they are similar to the CFTC's Rules of Practice ("CFTC RoP"),¹⁸¹ which govern CFTC administrative proceedings and were last amended in 1998.¹⁸² CFTC APs begin with a complaint and notice of hearing, authorized by the CFTC Commissioners on recommendation of the CFTC staff.¹⁸³ The CFTC RoP permit depositions only if the prospective witness will be unable to attend or testify at a hearing, the testimony is material, and it is necessary to take the deposition in the interests of justice.¹⁸⁴ Any party may apply to a CFTC ALJ for issuance of a subpoena requiring testimony

¹⁷⁵ 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> ("But appeals rarely succeed because the law requires courts to defer to the agency's judgment, especially on disputed facts.").

¹⁷⁶ *Gebhart*, 595 F.3d at 1040.

¹⁷⁷ 5 U.S.C. § 706(2)(A) (2012); *Rapoport v. SEC*, 682 F.3d 98, 103 (D.C. Cir. 2012); *KPMG, LLP v. SEC*, 289 F.3d 109, 121 (D.C. Cir. 2002).

¹⁷⁸ *World Trade Fin. Corp. v. SEC*, 739 F.3d 1243, 1247 (9th Cir. 2014).

¹⁷⁹ *See, e.g., Jarkey v. SEC*, 803 F.3d 9, 22 (D.C. Cir. 2015) (explaining that in the event that an appellate court finds the administrative record inadequate it always has an option of "remanding to the agency for further factual development"); *John Doe, Inc. v. DEA*, 484 F.3d 561, 569–70 (D.C. Cir. 2007) (stating that "where an insufficient administrative record is crippling, a court of appeals always has the option of . . . remanding to the agency for further factual development").

¹⁸⁰ The CFPB release adopting its Rules of Practice for Adjudication Proceedings references the SEC RoP sixty-six times. Jon Eisenberg, *We've Only Just Begun—Lessons from the CFPB's First 35 Enforcement Cases*, K&L GATES LLP (Mar. 5, 2014), <http://www.klgates.com/weve-only-just-begun-lessons-from-the-cfpbs-first-35-enforcement-cases-03-05-2014/>.

¹⁸¹ The CFTC RoP appear in 17 C.F.R. §§ 10.1-10.114 (2010). The CFTC's Rules relating to Investigations appear in 17 C.F.R. §§ 11.1-11.8 (2015).

¹⁸² *See* 63 Fed. Reg. 55784 (CFTC Oct. 19, 1998) (indicating the amendments adopted in 1998 were intended to facilitate communication and enhance other administrative duties of the CFTC).

¹⁸³ ALAN R. BROMBERG, LEWIS D. LOWENFELS & MICHAEL J. SULLIVAN, 6 BROMBERG & LOWENFELS ON SECURITIES FRAUD § 12:157 (2d ed. database updated Nov. 2014).

¹⁸⁴ 17 C.F.R. § 10.44(a) (2015).

at hearing or the production of documents, but the CFTC lacks independent authority to enforce subpoenas.¹⁸⁵

The AP is conducted before an ALJ, with staff members (usually from the CFTC Division) acting as prosecutors.¹⁸⁶ There is no jury.¹⁸⁷ Although the CFTC is not bound to follow the FRE, it looks to those rules for guidance in determining whether certain evidence is admissible.¹⁸⁸ Any party may appeal a final disposition by an ALJ. The first level of appeal is to the CFTC Commissioners, who determine sanctions *de novo*.¹⁸⁹

A further appeal may be taken to a federal court of appeals if the proceeding results in an order for the imposition of a civil penalty, the suspension of trading privileges, or the suspension or revocation of a registration.¹⁹⁰ Pre-Dodd-Frank the standard of review for factual findings by the CFTC was whether they were supported by the weight of the evidence. This standard, which was set forth in Section 6(c) of the CEA, was deleted when Congress amended 6(c) with Dodd-Frank.¹⁹¹ Post-Dodd-Frank the standard of review is likely to be supplied by the APA, which sets forth a substantial evidence standard.¹⁹² The standard of review for legal questions is plenary,¹⁹³ subject to *Chevron* deference for those questions within the CFTC's area of expertise.¹⁹⁴

II. CONSTITUTIONAL ATTACKS ON ADMINISTRATIVE PROCEEDINGS

Defendants have launched a broad array of constitutional attacks on the use by the SEC and CFTC of administrative proceedings. Five of the primary areas of attack concern due process, equal protection, the Seventh Amendment, and two distinct aspects of Article II of the U.S. Constitution. The multiple areas of attack are examined separately below.

185 Berkovitz, *supra* note 85.

186 BROMBERG ET AL., *supra* note 183, at § 12:157.

187 *Id.*

188 Berkovitz, *supra* note 85, at 6.

189 In re Grossfeld, CFTC No. 89-23, 1996 WL709219 at ¶26,921 (Dec. 10, 1996).

190 7 U.S.C. § 9(11) (2012).

191 Berkovitz, *supra* note 85.

192 *Id.*

193 *See, e.g.*, Lehoczky v. CFTC, 125 F.3d 844, at *1 (2d Cir. 1997); *see also* Armstrong v. CFTC, 12 F.3d 401, 403 (3d Cir. 1993).

194 *See, e.g.*, DiPlacido v. CFTC, 364 Fed. App'x 657, 661 (2d Cir. 2009) (“[W]here a question implicates Commission expertise, we defer to the Commission’s decision if it is reasonable.”) (internal quotation marks omitted).

A. *Due Process*

1. *Combination of Functions*

Due process arguments against the use of administrative proceedings by the SEC have taken several forms. One common form is that the vesting of investigative, prosecutorial, and adjudicative functions in a single agency constitutes a due process violation.¹⁹⁵ Criticism of the SEC's combination of functions has been asserted for decades,¹⁹⁶ but the constitutional argument has no merit. To begin, the combination of functions does not create a statutory violation. The APA prohibits agency staff from combining prosecutorial and adjudicative functions in the same case, but it expressly exempts both the agency and agency members from this prohibition.¹⁹⁷ The original rationale for this carve-out was that, in order to set agency-wide policy, agency governing bodies must be able to weigh in on both prosecutions and adjudications.¹⁹⁸

The absence of a statutory violation is mirrored by the absence of a constitutional violation. Both the Supreme Court and federal appellate courts have repeatedly held that the vesting of multiple functions in a single agency does not, without more, constitute a due process violation. The leading case is *Withrow v. Larkin*,¹⁹⁹ decided in 1975. In *Withrow* the Supreme Court rejected a claim that a state agency's power to investigate and adjudicate the same matter created a due process violation. The Court stated: "The initial charge or determination of probable cause and the ultimate adjudication have different bases and purposes. The fact that the same agency makes them in tandem and that they relate to the same issues does not result in a procedural due process violation."²⁰⁰ *Withrow* either strongly

195 See Stephen Bainbridge, *Should the SEC be Prosecutor, Judge, Jury, and Executioner?*, PROFESSORBAINBRIDGE.COM, Oct. 21, 2014, <http://www.professorbainbridge.com/professorbainbridge.com/2014/10/should-the-sec-be-prosecutor-judge-jury-and-executioner.html> (suggesting that the combination of functions may constitute a due process violation). See also John Falvey & Daniel Tyukody, *Duka Will Slow, Not Stop, SEC's In-House Court Trend*, LAW360 (Sept. 8, 2015), <http://www.law360.com/articles/699283/duka-will-slow-not-stop-sec-s-in-house-court-trend> ("[D]efendants have complained that in its in-house courts, the SEC acts as prosecutor, judge, jury, and the first line of appellate review.").

196 See Walfish, *supra* note 10 (noting intermittent criticism for nearly seventy years).

197 5 U.S.C. § 554(d) (2012).

198 Walfish, *supra* note 10.

199 421 U.S. 35, 36–37 (1975).

200 *Id.* at 58. See also Gary Lawson, *The Rise and Rise of the Administrative State*, 107 HARV. L. REV. 1231, 1249 (1994) ("The post-New Deal Supreme Court has never seriously questioned the constitutionality of this combination of functions in agencies."); Kevin M.

suggested or settled the permissibility of the APA-sanctioned multiple function regime under the U.S. Constitution. In *Blinder, Robinson & Co. v. SEC*,²⁰¹ the D.C. Circuit, citing *Withrow*, rejected a due process challenge to the SEC's use of administrative proceedings.²⁰²

The Federal Trade Commission ("FTC") is another federal agency which serves as an investigator, prosecutor, and judge. Apart from requests for preliminary injunctions filed in federal district court to enjoin proposed mergers pending administrative adjudication,²⁰³ most of the FTC's cases are adjudicated by an FTC ALJ,²⁰⁴ whose findings may be appealed to the five FTC Commissioners, who also authorize investigations and the issuance of complaints.²⁰⁵ The FTC's multiple roles have prompted criticism very similar to that which has been leveled against the SEC,²⁰⁶ but judicial challenges have failed. In *Kennecott Copper Corp. v. FTC*,²⁰⁷ the Tenth Circuit rejected a due process challenge to the FTC's structure. The court noted that Congress designed the FTC to combine the functions of investigator, prosecutor, and judge and "the courts have uniformly held that this feature does not make out an infringement of the due process clause of the Fifth Amendment."²⁰⁸ The D.C. Circuit also has rejected a due process challenge to the FTC's multiple roles.²⁰⁹

Stack, *Agency Independence After PCAOB*, 32 CARDOZO L. REV. 2391, 2397 (2011) ("The Court has consistently rejected challenges to combination of functions in federal administrative agencies as violating due process.").

201 837 F.2d 1099, 1114 (D.C. Cir. 1988).

202 *Id.* at 1104–07.

203 See Neal R. Stoll & Shepard Goldfein, *The FTC: Court of the Star Chamber?*, N.Y. L.J. (July 15, 2008), <https://www.skadden.com/insights/ftc-court-star-chamber> (describing generally the merger challenge process).

204 Bert Foer, *The Fairness Debate in the U.S.*, at 2 (June 28, 2014), <http://www.antitrustinstitute.org/content/foer-presents-ascola-conference-warsaw>.

205 See, e.g., David A. Balto, *The FTC at a Crossroads: Can it Be Both Prosecutor and Judge?*, 28 (No. 12) LEGAL BACKGROUNDER, 1, 1–3 (Aug. 23, 2013), http://www.dcantitrustlaw.com/08-23-13Balto_LB.pdf ("The FTC acts as both prosecutor and judge in administrative litigation. . . . [T]he FTC's almost two decade history of *always* ruling in its own favor creates a strong impression of unfairness."). The FTC's decisions can be appealed to the federal court of appeals. Shepard Goldfein & James A. Keyte, *Merger Review at FTC and Department of Justice*, N.Y. L.J. (Dec. 9, 2014), <https://www.skadden.com/sites/default/files/publications/070121417Skadden.pdf>.

206 See, e.g., Nicole Durkin, Essay, *Rates of Dismissal in FTC Competition Cases from 1950–2011 and Integration of Decision Functions*, 81 GEO. WASH. L. REV. 1684, 1686 (2013) ("One criticism in particular has persisted throughout the years: that the FTC's role as both prosecutor and adjudicator compromises the fairness of its adjudicatory functions.").

207 *Kennecott Copper Corp. v. FTC*, 467 F.2d 67, 79 (10th Cir. 1972).

208 *Id.* at 79.

209 *FTC v. Cinderella Career & Finishing Schs.*, 404 F.2d 1308, 1315 (D.C. Cir. 1968) ("It is well settled that a combination of investigative and judicial functions within an agency does not violate due process."); see also J. Thomas Rosch, Commissioner, Federal Trade

Given the settled nature of this issue, it is unsurprising that the combination in a single administrative authority of rulemaking, enforcement, and adjudicative power is the most common regulatory scheme of the federal government.²¹⁰ In short, the initial aspect of the due process attack on SEC administrative proceedings should fail. There are, however, other aspects. Due process arguments have also been made concerning specific administrative procedures used by the SEC and CFTC in adjudications by the agencies. This Article next considers those arguments.

2. *Limited Discovery*

One contentious aspect of the SEC RoP that has prompted due process arguments is the very narrow discovery allowed in SEC administrative proceedings. The Administrative Conference of the United States (“ACUS”), an independent federal agency established in 1968 and dedicated to improving the agency process,²¹¹ has advocated for broader discovery in SEC administrative proceedings for more than forty years²¹² but the SEC has vigorously resisted.²¹³

There are a number of key points regarding the discovery argument, which cut in different directions. First, it is well established that there is no constitutional right to discovery depositions—or any other pretrial discovery—in administrative proceedings.²¹⁴ Second,

Commission, *Remarks Before the American Bar Association Section of Antitrust Law Fall Forum, Three Questions About Part Three: Administrative Proceedings at the FTC* 12 n.34 (Nov. 8, 2012), https://www.ftc.gov/sites/default/files/documents/public_statements/three-questions-about-part-three-administrative-proceedings-ftc/121108fallforum.pdf (“The federal appellate courts have likewise repeatedly recognized that, by functioning in a quasi-prosecutorial, quasi-judicial dual role, the FTC does not violate litigants’ procedural due process.”).

210 See *Martin v. Occupational Safety & Health Review Comm’n*, 499 U.S. 144, 152–53 (1991) (noting predominance of this regulatory scheme). See also William Scherman, John Shepherd & Jason Fleischer, *The New FERC Enforcement: Due Process Issues in the Post-EPACT 2005 Enforcement Cases*, 31 ENERGY L.J. 55, 70 (2010) (noting that the Federal Energy Regulatory Commission “is the prosecutor, judge, and jury”).

211 See ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, *About the Administrative Conference of the United States (ACUS)*, <https://www.acus.gov/about-administrative-conference-united-states-acus> (explaining mission of the ACUS).

212 Mathews, *supra* note 140, at 250–51, 251 n.162.

213 See Peter J. Henning, *New Criticism Over the S.E.C.’s Use of In-House Judges*, N.Y. TIMES: DEALBOOK (July 20, 2015), http://www.nytimes.com/2015/07/21/business/dealbook/new-criticism-over-the-secs-use-of-in-house-judges.html?_r=0 (quoting Andrew Ceresney, Director, SEC Enforcement Division, for the proposition that expanded discovery in SEC APs “would significantly weaken the commission’s ability to protect investors through strong and effective enforcement of the federal securities laws”).

214 *Kelly v. EPA*, 203 F.3d 519, 523 (7th Cir. 2000); *Myers v. Norfolk Livestock Mkt.*, 696 F.2d 555, 557 (8th Cir. 1982); *Sims v. Nat’l Transp. Safety Bd.*, 662 F.2d 668, 671–72 (10th Cir.

limited discovery is not unique to SEC administrative enforcement. The APA, which is applicable to all federal administrative agencies, contains no provision for pretrial discovery in the administrative process.²¹⁵ The result is that discovery is generally denied by agencies in federal administrative proceedings.²¹⁶

Third, the SEC RoP's restrictions on discovery apply equally to all parties to SEC proceedings. Both respondents and the SEC are generally unable to pursue discovery once the OIP has been filed, and a feasible outcome is that the SEC will be saddled with a seriously incomplete investigative record.²¹⁷ Conversely, before the OIP has been filed, the SEC has enjoyed the luxury of conducting unilateral discovery for months or even years during the course of its investigation.²¹⁸ The luxury is not theoretical. Approximately 40% of the SEC's cases are filed more than two years after the agency begins an investigation²¹⁹ and during those years the SEC—aided by an expansive subpoena power²²⁰—is able to take sworn testimony from dozens of witnesses and collect millions of documents.²²¹ This aspect of the

1981); *Silverman v. Commodity Futures Trading Comm'n*, 549 F.2d 28, 33 (7th Cir. 1977).

²¹⁵ *Kelly*, 203 F.3d at 523.

²¹⁶ *See, e.g.*, William J. Scherman, Brandon C. Johnson & Jason J. Fleischer, *The FERC Enforcement Process: Time for Structural Due Process and Substantive Reforms*, 35 ENERGY L.J. 101, 118 (2014) (under rules of Federal Energy Regulatory Commission the “subjects of investigations have no discovery rights at all”).

²¹⁷ Davison et al., *supra* note 20, at 108 (“[O]nce the OIP is filed, the Enforcement Division trial lawyers face the same constraints; to the extent they discover holes in their case after the OIP is filed, they too are limited in their efforts to fill them.”); *see also* SHEARMAN & STERLING, LLP, *Securities Enforcement 2014 Year-End Review*, Jan. 2015, at 1, 4 <http://www.shearman.com/en/newsinsights/publications/2015/01/securities-enforcement-2014-year-end-review> (noting that absence of discovery in SEC APs may “equally impact both sides”).

²¹⁸ *See* Bromberg et al., *supra* note 183, at § 12.55 (“The SEC staff has had the benefit of discovery through its extensive investigative powers.”); *see also* Falvey & Tyukody, *supra* note 195, at 2, 4 (“[T]he SEC will often have developed its investigative record, including extensive witness testimony, over a period of years.”).

²¹⁹ U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 39 (“This statistic likely understates the length of a typical investigation.”).

²²⁰ *See* Adam L. Sisitsky, *Fear is Not Sufficient Grounds to Duck SEC Subpoena*, LAW360 (Sept. 3, 2015, 10:57 AM), <http://www.law360.com/articles/698673/fear-is-not-sufficient-grounds-to-duck-sec-subpoena> (“[T]here are few restrictions on the SEC’s subpoena power.”).

²²¹ *See* Stippich, *supra* note 146, at 5 (“[T]he Division will, in most cases, collect tens or hundreds of gigabytes of data comprising millions of pages of documents.”); *see also* Richard Foster, Comment Letter from the Financial Services Roundtable regarding the SEC’s Rules of Practice, to Brent J. Fields, Secretary, Securities and Exchange Commission, Dec. 4, 2015, at 4 <https://www.sec.gov/comments/s7-18-15/s71815.shtml> (“In the course of an investigation, the Division frequently collects millions of pages of electronic documents spanning many years from multiple parties.”); and Gretchen Morgenson, *Crying Foul on Plans to Expand the S.E.C.’s In-House Court System*, N.Y. TIMES (June 26, 2015),

discovery process may be most objectionable to respondents. One review noted: “The lack of pre-hearing discovery adversely affects the respondent rather than the SEC staff. . . . In effect, the staff is able to conduct its pre-hearing discovery before beginning the proceeding.”²²²

Fourth, the SEC has supported the propriety of narrow discovery in administrative proceedings by comparing the process to criminal cases. Whereas the prosecutor has the benefit of grand jury discovery, strictly limited discovery is available to criminal defendants.²²³ The SEC is factually correct but its analogy is flawed. The Supreme Court has repeatedly emphasized that there is no general constitutional right to discovery in criminal cases.²²⁴ Depositions are allowed in such cases but they are not intended as discovery devices.²²⁵ Rule 15(a) of the Federal Rules of Criminal Procedure authorizes the court to grant a motion for a deposition only to preserve for use at trial the testimony of a prospective witness,²²⁶ and this is the same isolated scenario in which depositions are allowed by the SEC RoP.

However, the SEC’s analogy is undercut because criminal defendants enjoy certain protections unavailable to respondents in SEC enforcement actions—in particular, no adverse inference can be drawn from the assertion of the Fifth Amendment privilege against self-incrimination,²²⁷ the government has the burden of proving its case

http://www.nytimes.com/2015/06/28/business/secs-in-house-justice-raises-questions.html?_r=0 (noting recent AP in which the SEC’s investigation lasted five years and the agency collected 2.4 million pages of documents and took sworn testimony from nineteen witnesses).

²²² U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 15. *Accord* Adam M. Wolper & Heidi VonderHeide, *The SEC’s Increased Use of Administrative Proceedings in Enforcement Actions: Background, Controversies, and Future Outlook*, 17 J. INV. COMPLIANCE 17, 19 (2016) (“By the time the OIP is filed, the SEC has its case virtually complete.”).

²²³ *See, e.g., Ceresney Remarks, supra* note 19, at 5 (“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. If that approach is acceptable when someone’s liberty is on the line, then it is hard to see how due process requires more for respondents in administrative proceedings.”).

²²⁴ *See, e.g., Weatherford v. Bursey*, 429 U.S. 545, 559 (1977) (“There is no general constitutional right to discovery in a criminal case, and Brady did not create one.”).

²²⁵ *In re Application of Eisenberg*, 654 F.2d 1107, 1113 n.9 (5th Cir. 1981).

²²⁶ FED. R. CRIM. P. 15(a)(1). To demonstrate that exceptional circumstances necessitate a Rule 15 deposition, the party seeking the deposition must show the materiality of the testimony and the unavailability of the witness to testify at trial. *United States v. Kelley*, 36 F.3d 1118, 1124–25 (D.C. Cir. 1994).

²²⁷ *See, e.g., Baxter v. Palmigiano*, 425 U.S. 308, 318 (1976) (permitting adverse inference to be drawn in civil action); *LiButti v. United States*, 107 F.3d 110, 121 (2d Cir. 1997) (“[W]hile the Fifth Amendment precludes drawing adverse inferences against defendants

beyond a reasonable doubt, and defendants have the right to a jury trial.²²⁸

Fifth, the discovery problem is compounded because the SEC often makes broad assertions of both the work product doctrine²²⁹ and the deliberative process privilege,²³⁰ and those assertions are typically upheld.²³¹ The Division discloses as part of the investigative file only transcribed testimony²³² and invokes the work product doctrine to justify non-disclosure of its staff notes of informal witness interviews.²³³ The SEC invokes the deliberative process privilege—the most frequently invoked governmental privilege²³⁴—to justify non-disclosure of a range of pre-decisional and deliberative documents concerning

in criminal cases, it does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them.”) (internal quotation marks omitted).

228 Kenneth B. Winer & Laura S. Kwaterski, *Assessing SEC Power in Administrative Proceedings*, LAW360 (Mar. 24, 2011, 1:47 PM), <http://www.law360.com/articles/233299/assessing-sec-power-in-administrative-proceedings>.

229 Randall R. Lee & Timothy C. Perry, *A “Cop on the Beat”?: Why the SEC Should Adopt the Brady Standard*, 83 U.S.L.W. 1097 (Jan. 27, 2015) (“[T]he SEC asserts a work product protection that is, as a practical matter, broader than what even a criminal prosecutor can claim.”).

230 See WILMER CUTLER PICKERING HALE & DORR, LLP, *Securities Litigation and Enforcement* (Mar. 14, 2013), https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/WH_Publications/Client_Alert_PDFs/Securities-Litigation-Enforcement-Update.pdf. (“[T]he SEC often invokes privilege—particularly deliberative process privilege—as a complete bar to discovery of its internal documents.”).

231 See, e.g., Lee & Perry, *supra* note 229 (noting that courts “have generally supported the SEC’s assertion of work product protection”). *But see* SEC v. Kovzan, No. 11-2017-JWL, 2012 WL 4819011, at *6 (D. Kan. Oct. 10, 2012) (rejecting the SEC’s blanket assertion of deliberative process privilege); SEC v. Collins & Aikman Corp., 256 F.R.D. 403, 415–17 (S.D.N.Y. 2009) (same); Jonathan Tuttle, *How to Level the Playing Field in SEC Civil Actions*, LAW360 (Jan. 8, 2013, 12:34 PM), <http://www.law360.com/articles/403848/how-to-level-the-playing-field-in-sec-civil-actions> (“The rejection [in *Kovzan*] of the SEC’s overly broad and oft-asserted claims of deliberative process and work product privileges should give those facing SEC civil actions some comfort that there are potential ways to ensure a level playing field and to discover the factual bases for the SEC’s asserted claims.”).

232 Barry R. Goldsmith, *SEC Proposed Amendments to Rules for Administrative Proceedings*, HARV. LAW SCH. F. ON CORP. GOV. & FIN. REG. (Oct. 15, 2015), <http://corpgov.law.harvard.edu/2015/10/15/sec-proposes-amendments-to-rules-for-administrative-proceedings/>; *Why the SEC’s Proposed Changes to its Rules of Practice are Woefully Inadequate—Part II*, SEC. DIARY (Nov. 5, 2015), <http://securitiesdiary.com/2015/11/05/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-ii/> (“The SEC staff is rarely required to provide access to its non-transcribed interviews . . .”).

233 Davison et al., *supra* note 20, at 107; SEC Rules of Practice, 17 C.F.R. § 201.230(b) (2016).

234 Edward J. Imwinkelried, *The Government’s Increasing Reliance on—and Abuse of—the Deliberative Process Evidentiary Privilege: “[T]he Last Will be First”*, 83 MISS. L.J. 509, 512 (2014) (“In the short period of its existence, the deliberative process doctrine has become the most frequently invoked governmental privilege.”).

agency policies.²³⁵ An off-setting factor is that SEC ALJs may be willing to grant respondents' requests that the SEC produce relevant materials that are outside the investigative file.²³⁶

A sixth key point concerns *Brady*. The SEC often attempts to deflect the due process argument by noting that when it discloses to respondents material exculpatory evidence under *Brady* the Division provides more expansive discovery in administrative proceedings than it does in federal court.²³⁷ In *Brady* the Supreme Court held that the suppression by the prosecution of evidence favorable to an accused violates due process where the evidence is material either to guilt or punishment.²³⁸ The Supreme Court has never considered whether *Brady* should apply to the government in civil cases.²³⁹ A few lower courts have held that *Brady* does apply civilly,²⁴⁰ but the SEC does not impose *Brady* obligations on its staff in civil cases. The SEC does impose such obligations in administrative proceedings,²⁴¹ as does the CFTC,²⁴² even though most other federal agencies do not²⁴³ and courts have held that due process does not require application of

235 See Michael N. Kennedy, Comment, *Escaping the Fishbowl: A Proposal to Fortify the Deliberative Process Privilege*, 99 NW. U. L. REV. 1769, 1772–73 (2005) (identifying elements of the privilege).

236 See, e.g., Harding Advisory, LLC, Admin. Proc. Rulings Rel. No. 1256, 2014 SEC LEXIS 636 at *6 (Feb. 24, 2014) (granting in part respondents' requests for documents outside the SEC's investigative file).

237 See, e.g., *Ceresney Remarks*, *supra* note 19, at 5 (“We also have affirmative *Brady* obligations to disclose material, exculpatory information and Jencks Act obligations to turn over statements of our witnesses—neither of which apply in our district court proceedings.”); Dennis K. Berman, *Mary Jo White Explains the New SEC Rules*, WALL ST. J. (Nov. 24, 2015, 7:28 AM), <http://www.wsj.com/articles/mary-jo-white-explains-the-new-sec-rules-1448302777> (quoting SEC Chairman Mary Jo White for proposition that whereas SEC must turn over Jencks and *Brady* material in APs, there is no similar requirement in federal district court).

238 *Brady v. Maryland*, 373 U.S. 83, 87 (1963). *Brady* was extended ten years later by *Giglio v. United States*, 405 U.S. 150, 154 (1972), which held that *Brady* requires prosecutors to disclose evidence affecting the credibility of witnesses.

239 *United States ex rel. Redacted v. Redacted*, 209 F.R.D. 475, 481 (D. Utah 2001) (collecting cases).

240 See *Brodie v. Dep't of Health & Human Servs.*, 951 F. Supp. 2d 108, 118 (D.D.C. 2013) (“With only three exceptions . . . courts uniformly have declined to apply *Brady* in civil cases.”).

241 17 C.F.R. § 201.230 (2014).

242 See, e.g., *In re First Guar. Metals Co.*, CFTC No. 79-55, 1980 WL 15696, at *9 (July 2, 1980) (adopting *Brady* rule by decision of CFTC ALJ).

243 See Justin Goetz, Note, *Hold Fast the Keys to the Kingdom: Federal Administrative Agencies and the Need for Brady Disclosure*, 95 MINN. L. REV. 1424, 1431 (2011) (“[M]ost agencies do not include the [*Brady*] rule in their procedures for formal adjudication.”).

Brady in APs.²⁴⁴ Pursuant to Rule 231(a)²⁴⁵ the SEC also makes available documents that could be used to impeach a trial witness, in accord with the principles of the Jencks Act,²⁴⁶ even though the Jencks Act applies only to discovery in criminal cases.²⁴⁷

The SEC's *Brady* argument has superficial appeal. By applying *Brady* in their administrative proceedings the SEC and CFTC provide more expansive disclosure than do many other agencies. The FTC, for example, has declined to apply *Brady* in its administrative proceedings.²⁴⁸ Similarly, the National Labor Relations Board ("NLRB") and the Financial Industry Regulatory Authority ("FINRA"), whose proceedings are treated as the equivalent of administrative agency action, have chosen not to apply *Brady*.²⁴⁹ Indeed, a recent survey found that the SEC and CFTC are two of only five federal agencies that have adopted *Brady*.²⁵⁰

Nevertheless, the SEC's argument ultimately is unconvincing. First, the Division and defense counsel may have widely divergent views of what constitutes *Brady* material, with the possible result that some or even much material exculpatory evidence is withheld.²⁵¹ The experience of the few other federal agencies that have adopted the case suggests that this is a common problem. A recent review of the adoption of *Brady* by the Federal Energy Regulatory Commission

²⁴⁴ See, e.g., *NLRB v. Nueva Eng'g, Inc.*, 761 F.2d 961, 969 (4th Cir. 1985) ("[W]e find *Brady* inapposite and hold that the ALJ properly denied Nueva's demand for exculpatory materials.").

²⁴⁵ 17 C.F.R. § 201.231 (2016).

²⁴⁶ 18 U.S.C. § 3500 (2012). The Jencks Act is a statute that applies in criminal proceedings, but "the SEC has imported its basic principles to administrative proceedings." *DOREMAN & WINER*, *supra* note 22, at § 19.04(6) n.34. Cf. *Silverman v. CFTC*, 549 F.2d 28, 34 (7th Cir. 1977) (holding that Jencks Act does not apply to CFTC AP).

²⁴⁷ *Campbell v. Eastland*, 307 F.2d 478, 486 (5th Cir. 1962).

²⁴⁸ *Amrep Corp.*, 102 F.T.C. 1362, 1371 (1983).

²⁴⁹ See, e.g., *Mister Disc. Stockbrokers, Inc. v. SEC*, 768 F.2d 875, 878 (7th Cir. 1985) (finding no right to exculpatory evidence in proceedings of National Association of Securities Dealers, which was predecessor to FINRA); *NLRB v. Nueva Eng'g, Inc.*, 761 F.2d 961, 969 (4th Cir. 1985) (holding the *Brady* rule inapplicable to NLRB proceedings); *Zandford v. Nat'l Ass'n Sec. Dealers*, 30 F. Supp. 2d 1, 22 n.12 (D.D.C. 1998) ("NASD procedures do not require the disclosure of exculpatory evidence.").

²⁵⁰ See *Goetz*, *supra* note 243, at 1425 n.11 (identifying the SEC, CFTC, Federal Maritime Commission, Federal Deposit Insurance Corporation, and Federal Energy Regulatory Commission).

²⁵¹ See *Why the SEC's Proposed Changes to its Rules of Practice are Woefully Inadequate—Part IV*, SEC. DIARY (Dec. 3, 2015), <http://securitiesdiary.com/2015/12/04/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-iv/> ("[T]he SEC staff's determination of what is *Brady* and *Jencks* material is notoriously narrow. In the staff's view, if a document does not itself say that the respondent is innocent, it is not exculpatory—which leaves out many documents that are building blocks in proving the respondent's innocence . . .").

(“FERC”) found that FERC enforcement staff “routinely fails to produce exculpatory documents, either in response to general requests for *Brady* materials or in response to requests for particular categories of documents.”²⁵² Second, the SEC has adopted a relaxed form of the *Brady* rule. As applied in criminal cases, *Brady* requires that prosecutors disclose exculpatory or potentially exculpatory materials known to them and it imposes an affirmative duty on prosecutors to search for such evidence in their own files.²⁵³ But whereas SEC RoP 230(b)(2) prohibits the Division from withholding documents that contain material exculpatory evidence, the rule does not impose an affirmative duty to identify or disclose such evidence.²⁵⁴

Overall, while the major arguments concerning limited discovery in SEC (and CFTC) APs cut in different directions, the bottom line is that such limitations are not unconstitutional but they are unfair. Possibly the most salient issue is that whereas before the OIP has been filed the SEC has enjoyed the luxury of conducting unilateral discovery for many months during the course of its investigation, a reciprocal opportunity is unavailable to respondents. This seems fundamentally unfair, especially when considered in conjunction with the SEC’s AP timeline.

3. *Compressed Timeline*

A common argument is that the strict timeline for completion of an SEC administrative proceeding denies due process to respondents.²⁵⁵ The specific point is that the Division often commences an

²⁵² William S. Scherman, Brandon C. Johnson & Jason J. Fleischer, *The FERC Enforcement Process: Time for Structural Due Process and Substantive Reforms*, 35 ENERGY L.J. 101, 117 (2014). *Accord* William Scherman & Jason Fleischer, *2014 FERC Enforcement Year in Review*, LAW360 (Dec. 22, 2014, 11:52 AM), <http://www.law360.com/articles/605676/2014-ferc-enforcement-year-in-review> (noting that FERC “has a poor, virtually nonexistent, record of producing exculpatory information to the subjects of investigations.”). *See also* Todd Mullins & McEachran, *supra* note 91, at 279 (observing that when FERC staff produces documents that arguably constitute *Brady* material, it does so too late in the investigative process for subjects of investigation to effectively use the material). *But see* Allison Murphy, Todd Hettenbach & Thomas Olson, *The FERC Enforcement Process*, 35 ENERGY L.J. 283, 308–09 (2014) (“It is not uncommon for counsel representing investigative subjects to characterize many categories of information as *Brady* material when, in fact, such information does not fall within the *Brady* doctrine and counsel are attempting to use [FERC’s] policy as a discovery device.”).

²⁵³ *United States v. Brooks*, 966 F.2d 1500, 1502 (D.C. Cir. 1992).

²⁵⁴ Goetz, *supra* note 243, at 1436–37. *But cf.* Mixter, *supra* note 136, at 57 (“Nevertheless, Rule 230(b)(2) is treated in practice as granting full-fledged *Brady* rights.”).

²⁵⁵ *See, e.g.*, *Dearlove v. SEC*, 573 F.3d 801 (D.C. Cir. 2009) (rejecting due process claim); *Chau v. SEC*, 72 F. Supp. 3d 417, 426–27 (S.D.N.Y. 2014) (noting due process claim that

enforcement proceeding after it has spent years investigating the facts and collecting documents, whereas respondents have only a few short months after the OIP is filed to review potentially millions of pages of documents.²⁵⁶ In fiscal year 2015 the mean time between the commencement by the SEC of an investigation and the commencement of an enforcement action was twenty-four months.²⁵⁷ And as noted, under the commonly used 300-day timeline, the hearing must be scheduled for a date approximately four months from service of the OIP. Extensions may be granted, but the SEC has adopted an explicit policy of strongly disfavoring extensions, postponements, or adjournments.²⁵⁸

Several points are key. First, the D.C. Circuit has examined and rejected the due process argument concerning the SEC's compressed time frame. In *Dearlove v. SEC*²⁵⁹ the court rejected a claim, asserted by an accountant debarred from practice before the SEC, that he was denied due process because (a) he had only four months in which to review a massive record compiled by the Commission during several years of investigation and (b) his request for a sixty-day postponement of his administrative hearing had been denied.²⁶⁰

Second, it is inaccurate to state that respondents in SEC administrative proceedings have only the few months between the filing of an OIP and the date of the hearing in which to review relevant documents and ascertain the relevant facts. Respondents do not receive their first inkling of an enforcement action with the filing of an OIP. Rather, first notice usually is received during the Wells submission process,²⁶¹ which has been described as the SEC's "central due process mechanism in enforcement matters."²⁶² For more than forty years the SEC has had a policy requiring, in most cases, that Division staff con-

SEC dumped 22 million documents on respondents in a 300-day case), *aff'd*, No. 15-461, 2016 WL 7036830 (2d Cir. Dec. 2, 2016).

²⁵⁶ See Aronow, *supra* note 88, at 4 ("While the staff has often taken years, the defendants seldom have more than months to prepare.").

²⁵⁷ Jonathan N. Eisenberg, *13 Observations About the SEC's Enforcement Program*, HARV. L. SCH. F. ON CORP. GOV. AND FIN. REG. (Apr. 18, 2016), <https://corpgov.law.harvard.edu/2016/04/18/13-observations-about-the-secs-enforcement-program/>. See also Choi & Pritchard, *supra* note 71, at 14 ("[M]ost investigations will last more than a year, and several years is not uncommon.").

²⁵⁸ 17 C.F.R. § 201.161 (2016).

²⁵⁹ 573 F.3d 801 (D.C. Cir. 2009).

²⁶⁰ *Id.* at 807.

²⁶¹ DORFMAN & WINER, *supra* note 22, at § 19.04(1).

²⁶² Paul S. Atkins, Commissioner, U.S. Sec. & Exch. Comm'n, Remarks Before the Security Traders Ass'n of New York 71st Annual Conference (Apr. 19, 2007), <https://www.sec.gov/news/speech/2007/spch041907psa.htm>.

ducting an investigation give notice to prospective defendants of the staff's plan to recommend that they be sued and of the potential charges.²⁶³ The so-called Wells notice, which typically is cursory,²⁶⁴ also advises prospective defendants of their opportunity to respond by making a written Wells submission to tell their side of the story and argue against charges or for a reduction of charges before the SEC decides whether to commence an adjudicative proceeding.²⁶⁵ The Wells process also provides for the discretionary disclosure to the subjects of an investigation of non-privileged portions of the Division staff's investigative file.²⁶⁶

In addition to disclosures made during the Wells process, Division staff will usually notify prospective respondents when the SEC has authorized the OIP filing and the initiation of settlement discussions.²⁶⁷ The Wells process and this advance notice can expand the actual time frame that respondents in SEC APs have for reviewing key evidence, if the SEC shares such evidence during the Wells process. In any event, respondents may already be familiar with much of the critical evidence, especially in the form of testimony from their own employees provided to the SEC during the pre-filing investigation.²⁶⁸

²⁶³ Marc J. Fagel, *Reassessing the SEC Wells Submission*, 47 REV. SEC. & COMMOD. REG. 17, 17 (2014).

²⁶⁴ Stephanie Russell-Kraft, *Law360's SEC Survival Guide: The Wells Notice and Beyond*, LAW360 (July 31, 2014, 7:26 PM), <http://www.law360.com/articles/561108/law360-s-sec-survival-guide-the-wells-notice-and-beyond>.

²⁶⁵ Jean Eaglesham, *SEC Drops 20% of Probes After 'Wells Notice'*, WALL ST. J. (Oct. 9, 2013, 8:02 PM), <http://www.wsj.com/articles/SB10001424052702304500404579125633137423664>; see also Joshua A. Naftalis, Note, "Wells Submissions" to the SEC as Offers of Settlement Under Federal Rule of Evidence 408 and Their Protection from Third-Party Discovery, 102 COLUM. L. REV. 1912, 1913 (2002) ("Prospective defendants use . . . 'Wells Submissions' . . . after the conclusion of a staff investigation but before the [SEC] brings formal charges.").

²⁶⁶ OFFICE OF CHIEF COUNSEL, SEC DIV. OF ENF'T, *Enforcement Manual*, at 21 (June 4, 2015), <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf> ("On a case-by-case basis, the staff has discretion to allow the recipient of the notice to review portions of the investigative file that are not privileged.").

²⁶⁷ See DORFMAN & WINER, *supra* note 22, § 19.04(1) (explaining that prospective respondent will ordinarily receive advance notice of OIP).

²⁶⁸ *Ceresney Remarks*, *supra* note 19 ("[I]n many cases respondents know full well what the important evidence is, either because they produced it to us themselves, because it was testimony from their own employees or someone else to whom they have access before the hearing, or because we have shared it with them in testimony or in the course of Wells discussions."); see also Stephanie Russell-Kraft, *Ceresney Rebuts Rakoff's Critique Of SEC Admin. Actions*, LAW 360 (Nov. 7, 2014, 3:30 PM), <http://www.law360.com/articles/594489/ceresney-rebuts-rakoff-s-critique-of-sec-admin-actions> (citing Ceresney for the propositions that "the SEC's evidence in administrative proceedings often comes from the defense," and that "[b]y the time defendants get to trial, 'they know almost exactly what our case is going to be'").

The same is true with regard to the CFTC. The CFTC has informal procedures²⁶⁹ for providing notice of charges that are very similar in substance, but not identical, to the SEC's Wells process.²⁷⁰ Historically, the CFTC Division viewed its Wells process as discretionary,²⁷¹ but in recent years that view has changed so now prospective CFTC respondents can more safely assume that Wells notice will be provided to them.²⁷²

The SEC and CFTC Wells processes, and advance notice of filings, can help moderate the harsh effect of the compressed AP timelines, but they fail to solve the problem. First, the expanded window in which to learn the relevant facts has an upper limit of six months, because Dodd-Frank requires an enforcement action to be brought, if at all, within 180 days after submission of a written Wells notice to a prospective defendant.²⁷³ Second, the disclosure by the SEC staff of the non-privileged portions of its investigative file is entirely discretion-

269 In 1986 the CFTC rejected a petition to adopt a rule that would have assured parties under investigation of the right to make Wells submissions. Charles R. Mills & Benjamin J. Oxley, *Comparing the "Wells Processes" of the SEC, CFTC, and FERC: Is There Room for Improvement?*, A.B.A. COMM. ON REG. OF FUTURES & DERIVATIVE INSTRUMENTS (Jan. 31-Feb. 2, 2008), at 9 n.26, http://www.americanbar.org/content/dam/aba/events/business_law/2008/1/derivatives/enforcement-developments-200801.authcheckdam.pdf.

270 The CFTC's "Wells process" is outlined in *Informal Procedures Relating to the Recommendation of Enforcement Proceedings*, 17 C.F.R., pt. 11, app. A (2016).

271 See Mills & Oxley, *supra* note 269, at 9 ("[T]he CFTC Wells process has suffered in a number of cases from a seeming aversion of the Enforcement staff to identify and share the evidentiary basis for and legal theories that support a contemplated enforcement recommendation.").

272 See Deborah Heilizer, Gregory Kaufman & Jae Yoon, *The CFTC Flexes its Enforcement Muscles: Some Tips for Handling CFTC Administrative Proceedings*, BLOOMBERG L. REPS. (Jan. 9, 2012), <http://www.sutherland.com/portalresource/lookup/poid/Z1tOI9NPluKPtDNIqLMRV56Pab6TfzRXncKbDtRr9tObDdEv0JEo0!/fileUpload.name=/Heilizer%20-%20Bloomberg%20Securities%20Law%2001.09.2012.pdf> (indicating that CFTC's Division of Enforcement did not make Wells notices available to prospective respondents as a matter of course); Amanda Jawad & Sung-Hee Su, *The ABC's of CFTC Enforcement Actions*, 46 BLOOMBERG BNA SEC. REG. & L. REP. 1447, 1447 n.2 (July 28, 2014) (noting that historically CFTC Wells notices have not always been provided as a matter of course).

273 MARC I. STEINBERG & RALPH C. FERRARA, 25 SEC. PRAC. FED. & STATE ENFORCEMENT § 3.56 (database updated Sept. 2015). However, the Division may obtain one or more extensions of the six-month period if an investigation is sufficiently complex. 15 U.S.C. § 78d-5(a)(2) (2012). Another relevant factor is that increasingly the Division makes greater use of voluntary "white paper" submissions by defense counsel which frequently focus on specific factual or legal questions that are significant to the investigation. See Ronald S. Betman & Scott M. Ahmad, *Understanding and Navigating the Use of Pre-Wells Notice White Papers in Formal SEC Investigations*, 2014 BANKING L.J. 444, 446-47 (discussing differences between white papers and Wells submissions). The Division does not treat white papers as subject to the 180-day time limit for commencing proceedings after submission of a written Wells notice, a document which is not defined in either Dodd-Frank or the federal securities laws. U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 22.

ary, and the informal CFTC Wells process does not provide for any disclosure. The SEC Enforcement Manual identifies three factors to guide the exercise of discretion: (1) whether access would be productive for assessing the strength of evidence, (2) whether the person has been cooperative in providing evidence, and (3) the stage of the investigation, with respect to testimony from other witnesses or the pendency of criminal investigations or prosecutions.²⁷⁴ Some evidence suggests a recent trend by SEC staff to deny requests for access to the investigative file.²⁷⁵ Third, while SEC staff typically provides defense counsel with advance notice of the date when *settled* actions will be filed, “[t]here is no comparable presumption for filing litigated actions.”²⁷⁶

4. Evidence Rules

Another due process argument is that process is denied because the FRE do not apply in SEC administrative proceedings. This argument is unpersuasive for multiple reasons. First, the SEC is not unique in this regard—the FRE generally do not apply to federal administrative proceedings.²⁷⁷ Second, agencies enjoy no specific advantage simply because the FRE are inapplicable. No party to an SEC administrative proceeding has an inherent advantage regarding the admission or exclusion of evidence, and the SEC’s evidentiary motions are often denied.²⁷⁸ As noted, the SEC RoP permit the admission of hearsay, and such evidence can furnish the basis for finding a violation of securities law. Critics of SEC administrative enforcement highlight this fact.²⁷⁹ The use of hearsay evidence has a long history

²⁷⁴ OFFICE OF CHIEF COUNSEL, SEC DIV. OF ENF’T, *supra* note 266, at 22.

²⁷⁵ See U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 24 (“[T]he trend in recent years has been away from providing access.”).

²⁷⁶ *Id.*

²⁷⁷ See, e.g., William Scherman, John Shepherd & Jason Fleischer, *The New FERC Enforcement: Due Process Issues in the Post-EPACT 2005 Enforcement Cases*, 31 ENERGY L.J. 55, 69 (2010) (“It has long been the case at the FERC that the [FRE] do not apply . . .”).

²⁷⁸ See, e.g., Thomas C. Gonnella, Admin. Proc. Rulings Release No. 1579, 2014 SEC LEXIS 2349, at *5–6 (July 2, 2014) (denying SEC’s motion to exclude testimony of character witnesses).

²⁷⁹ See, e.g., Joel M. Cohen, Mary Kay Dunning & Darcy Harris, *SEC Plans to Play Insider-Trading Cases on Home Court*, NAT’L L.J., Sept. 16, 2014 (“[E]vidence deemed too unreliable to be admissible under the Federal Rules of Evidence—most notably hearsay evidence—is admissible in administrative proceedings. This, too, plays unfairly to the SEC’s advantage.”); AKIN GUMP STRAUSS HAUER & FELD, LLP, *SDNY Judge Berman Enjoins SEC Administrative Proceeding as “Likely Unconstitutional,” Litigation Alert* (Aug. 14, 2015), <https://www.akingump.com/en/news-insights/sdny-judge-berman-enjoins-sec->

in administrative proceedings, but this history began in an era when agencies—including the SEC—used APs for more limited, largely regulatory purposes. Nevertheless, critics may be overstating the impact of hearsay’s admissibility, because in practice SEC ALJs often conclude that hearsay statements are unreliable, especially where they lack traditional indicia of trustworthiness.²⁸⁰ CFTC ALJs also have required that hearsay statements be reliable.²⁸¹ In any event, the less formal evidentiary practice in APs can operate to respondents’ advantage, by permitting the admission of helpful evidence that might have been excluded under the FRE.²⁸²

In summary, federal courts have generally rejected due process challenges used by the SEC and CFTC in adjudications by the agencies.²⁸³ These outcomes have been appropriate, for the reasons noted above. But certain aspects of the process are fundamentally unfair. The next Part of this Article considers a different line of attack by respondents—that the selective use of APs constitutes an equal protection violation.

B. Equal Protection

A number of respondents in SEC administrative proceedings have alleged that they received uniquely unfavorable treatment compared with other similarly situated defendants who were sued by the SEC in federal court, rather than on the SEC’s home turf.²⁸⁴ This “class-of-one” equal protection argument was first litigated by a defendant sued by the SEC in 2011 in *Gupta v. SEC*.²⁸⁵ The SEC had issued an OIP against Rajat K. Gupta, alleging that he had knowingly disclosed material, nonpublic information about Goldman Sachs Group, Inc.

administrative-proceeding-as.html (asserting that introduction of hearsay during SEC APs places respondents at a disadvantage).

280 Davison et al., *supra* note 20, at 110. *But cf.* Olson, *supra* note 129, at 10 (“[R]eliability is a ‘malleable’ concept. Practice and precedent suggest that ALJs will construe it loosely so that it will fail to offer meaningful protection.”).

281 *See, e.g., In re Abrams*, CFTC No. 88-10, 1995 WL 455791, at *6–7 (July 31, 1995) (holding that evidence of trader’s activities was double hearsay and there was insufficient basis for establishing its reliability).

282 *See* Aronow, *supra* note 88, at 4 (“The less formal, less rule-bound procedures of the administrative hearing can often facilitate defendants’ efforts to introduce into evidence potentially relevant information that might be more problematic under a strict application of the Federal Rules of Evidence.”).

283 *See, e.g., Berkovitz*, *supra* note 85, at 8 (analyzing unsuccessful due process challenges to CFTC administrative proceedings).

284 *See, e.g., Bebo v. SEC*, 799 F.3d 765, 768 (7th Cir. 2015) (noting equal protection and due process arguments raised by respondent).

285 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

and Procter & Gamble Co.—on whose boards he served—to Raj Rajaratnam, the principal of Galleon Management, LP, who then traded on the basis of Gupta’s inside information.²⁸⁶ In the eighteen months prior to filing the OIP the SEC filed complaints in federal district court against twenty-one other individuals and seven entities accused of Galleon-related insider trading (many of whom were subject to direct regulation by the SEC), using language substantially similar to the language in the OIP and seeking remedies similar to the relief it sought against Gupta.²⁸⁷ The Galleon scheme has been described as the largest-ever insider trading scheme.²⁸⁸

Gupta sued the SEC in federal district court for the Southern District of New York, seeking declaratory and injunctive relief. He alleged, *inter alia*, that the SEC’s decision to deprive him, alone, of the opportunity to contest the SEC’s insider trading allegations in federal court singled him out for uniquely unfavorable treatment in violation of the Equal Protection Clause.²⁸⁹ Gupta further alleged that the SEC’s administrative action deprived him of the procedural safeguards of federal court, including the right to a trial by jury.²⁹⁰

The SEC moved to dismiss Gupta’s complaint, but Judge Jed Rakoff denied the motion,²⁹¹ writing: “[W]e have the unusual case where there is already a well-developed public record of Gupta being treated substantially disparately from 28 essentially identical defendants, with not even a hint from the SEC, even in their instant papers, as to why this should be so.”²⁹²

286 Joan E. McKown, *Administrative Proceeding against Rajat Gupta Marks a Turning Point in SEC Enforcement Actions*, 5 BLOOMBERG L. REP. (2011). The SEC could have pursued the administrative action against Gupta even if its authority had not been expanded by Dodd-Frank, because he was charged as someone associated with a regulated entity (Goldman Sachs). *Id.*

287 *Gupta*, 796 F. Supp. 2d at 506.

288 See Lawrence J. Zweifach & Eric M. Creizman, *Defending Parallel Proceedings: Basic Principles & Tactical Considerations*, SEC. LITIG. REP., Feb. 2010, at 1, 3 (noting that prosecutors have deemed Galleon’s insider trading scheme the “largest-ever insider trading scheme”).

289 *Gupta*, 796 F. Supp. 2d at 506–07.

290 *Id.* at 507.

291 Porter Wright, *Gupta Complaint Against the SEC Survives Motion to Dismiss On Equal Protection Grounds*, FED. SEC. L. SOURCE (July 12, 2011), <http://www.fedseclaw.com/2011/07/articles/sec-news/gupta-complaint-against-the-sec-survives-motion-to-dismiss-on-equal-protection-grounds/>.

292 *Gupta*, 796 F. Supp. 2d at 514. Prior to issuing his decision Judge Rakoff characterized the SEC’s disparate treatment of Gupta as “bizarre.” Patricia Hurtado, *Gupta Administrative Action by SEC is “Bizarre,” Judge Says*, BLOOMBERGBUSINESS (Mar. 16, 2011, 6:05 PM), <http://www.bloomberg.com/news/articles/2011-03-16/galleon-case-judge-calls-bizarre-sec-decision-not-to-sue-insider-gupta>.

The SEC did not seek reconsideration and—possibly fearing an adverse appellate ruling on the equal protection issue—did not seek certification to take an interlocutory appeal. Understandably reluctant to sit for depositions in Gupta’s federal action, the SEC instead opted to dismiss the administrative proceeding against Gupta, who in exchange agreed to dismiss his federal action against the agency.²⁹³ Gupta was subsequently indicted on several counts of securities fraud. Gupta was convicted following a jury trial before Judge Rakoff in June 2012, sentenced to twenty-four months in prison, fined \$5 million, and ordered to pay restitution of \$6.2 million.²⁹⁴ Gupta’s criminal conviction was affirmed on appeal²⁹⁵ and the Supreme Court denied certiorari.²⁹⁶

The day after Gupta was indicted, the SEC filed a civil complaint against Gupta and Rajaratnam in federal court, based on the same insider trading scheme described in the indictment. The SEC successfully moved for summary judgment against Gupta. Judge Rakoff imposed a civil penalty of \$13.9 million and granted a permanent injunction barring Gupta from serving as an officer or director of a public company, associating with brokers, dealers or investment advisors, and further violating securities law.²⁹⁷ The Second Circuit affirmed²⁹⁸ and the Supreme Court denied certiorari.²⁹⁹

A number of defendants—probably emboldened by Judge Rakoff’s denial of the SEC’s motion to dismiss in *Gupta*—have since asserted similar equal protection claims based on class-of-one theories.³⁰⁰ These claims are defective, and denial of the SEC’s motion to dismiss in *Gupta* likely constituted a rare misstep by Judge Rakoff.

The class-of-one doctrine provides that a plaintiff can assert an equal protection claim alleging discrimination against her in her in-

293 U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 13–14.

294 United States v. Gupta, 925 F. Supp. 2d 581, 588 (S.D.N.Y. 2013); United States v. Gupta, 904 F. Supp. 2d 349, 355 (S.D.N.Y. 2012).

295 United States v. Gupta, 747 F.3d 111, 140 (2d Cir. 2014).

296 Gupta v. United States, 135 S. Ct. 1841 (2015). Judge Rakoff subsequently denied a *habeas corpus* motion by Gupta to vacate his sentence and the judgment. United States v. Gupta, 111 F. Supp. 3d 557, 561 (S.D.N.Y. 2015).

297 SEC v. Gupta, No. 11 Civ. 7566 (JSR), 2013 WL 3784138, at *5 (S.D.N.Y. July 17, 2013).

298 SEC v. Gupta, 569 F. App’x 45 (2d Cir. 2014).

299 SEC v. Gupta, 135 S. Ct. 976 (2015).

300 *See, e.g.*, Jarkesy v. SEC, 803 F.3d 9, 14 (D.C. Cir. 2015) (describing appellants’ class-of-one theory alleging that appellee’s decision to charge appellants in agency proceeding was motivated by animus); Chau v. SEC, 72 F. Supp. 3d 417, 431 (S.D.N.Y. 2014) (remarking that plaintiffs do not purport to belong to a protected class but instead raise a class-of-one claim), *aff’d*, No. 15-461, 2016 WL 7036830 (2d Cir. Dec. 2, 2016).

dividual capacity, in contrast to the standard template in which a plaintiff alleges discrimination based on her group status—for example, as a member of a particular racial group or as a member of the female sex. The theory has been recognized, but not fully articulated, by the United States Supreme Court in two cases—*Village of Willowbrook v. Olech*³⁰¹ (decided in 2000) and *Engquist v. Oregon Department of Agriculture*³⁰² (decided in 2008). In those cases the Court held that a class-of-one equal protection claim is cognizable where an individual alleges that she has been “intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment.”³⁰³

The Seventh Circuit has noted that the law concerning class-of-one equal protection claims “is in flux.”³⁰⁴ This is charitable. The theory has also been described as a “doctrinal morass.”³⁰⁵ However, some aspects of the theory are clear. In order to establish a class-of-one equal protection violation, a plaintiff must first show that she was intentionally treated differently from others similarly situated.³⁰⁶ Appellate courts have strictly construed this requirement by holding that plaintiff and her comparators must be “*prima facie* identical in all relevant respects or directly comparable . . . in all material respects.”³⁰⁷ Plaintiff also must show that there was no rational basis for the differential treatment.³⁰⁸ This second prong has generated confusion and conflicting opinions. Some appellate panels have held that a plaintiff must show both that defendant acted irrationally and that defendant acted with illegitimate animus.³⁰⁹ Other appellate panels have held

301 528 U.S. 562 (2000) (per curiam).

302 553 U.S. 591 (2008).

303 *Vill. of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000) (per curiam).

304 *Del Marcelle v. Brown Cty. Corp.*, 680 F.3d 887, 888 (7th Cir. 2012) (per curiam).

305 *Christian Heritage Acad. v. Okla. Secondary Sch. Activities Ass’n*, 483 F.3d 1025, 1043 (10th Cir. 2007) (McConnell, J., concurring in part and dissenting in part); see also William D. Araiza, *Flunking the Class-of-One/Failing Equal Protection*, 55 WM. & MARY L. REV. 435, 441 (2013) (noting “extensive confusion in the lower courts” following *Olech* and *Engquist*, and concluding that “the Supreme Court continues to flunk the class-of-one”).

306 See, e.g., *Andy’s BP, Inc. v. City of San Jose*, 605 F. App’x 617, 618 (9th Cir. 2015).

307 *United States v. Moore*, 543 F.3d 891, 896 (7th Cir. 2008) (quoting *Racine Charter One, Inc. v. Racine Unified Sch. Dist.*, 424 F.3d 677, 680 (7th Cir. 2005)); accord *Ruston v. Town Bd. for Town of Skaneateles*, 610 F.3d 55, 59 (2d Cir. 2010) (quoting *Clubsides, Inc. v. Valentin*, 468 F.3d 144, 159 (2d Cir. 2006)) (“[C]lass-of-one plaintiffs must show an extremely high degree of similarity between themselves and the persons to whom they compare themselves.”) (internal quotation marks omitted).

308 See, e.g., *Andy’s BP, Inc.*, 605 F. App’x at 618.

309 See *Racine Charter One, Inc. v. Racine Unified Sch. Dist.*, 424 F.3d 677, 684 (7th Cir. 2005) (citing collected Seventh Circuit cases requiring proof of illegitimate animus). Other circuits also have concluded that animus or impermissible motive is an element of

that plaintiff must prove that the differential treatment was either irrational or motivated by illegitimate animus.³¹⁰

Notwithstanding the doctrinal confusion, the theory can be discussed with reference to Gupta. Gupta probably was intentionally treated differently from others similarly situated. Specifically, he was treated differently from the other twenty-eight individuals and entities accused of Galleon-related insider trading who were sued by the SEC in federal court. These other defendants probably were directly comparable in all material respects. But Gupta's claim still was defective, and the SEC's motion to dismiss should have been granted, for the reasons explained below.

In *Engquist*, the Supreme Court noted that the class-of-one theory is a poor fit when the challenged governmental action is the product of a broadly discretionary decision-making process.³¹¹ The Court refused to apply the theory to claims concerning public employment decisions.³¹²

The Supreme Court's holding was limited to the employment context,³¹³ but numerous courts have since extended *Engquist* by underscoring that class-of-one claims are an especially poor fit in criminal justice cases involving the exercise of prosecutorial discretion, parole board determinations, and police officers' decisions to cite or arrest particular individuals.³¹⁴ For example, in *United States v. Moore*,³¹⁵ the Seventh Circuit noted that an exercise of prosecutorial discretion cannot be successfully challenged on the ground that it is arbitrary—in the realm of prosecutorial charging decisions, only invidious discrimination is forbidden.³¹⁶ The Seventh Circuit further noted that where a challenge to the exercise of prosecutorial discretion is premised on irrationality, rather than invidious discrimination,

the claim. See *Del Marcelle v. Brown Cty. Corp.*, 680 F.3d 887, 892 (7th Cir. 2012) (per curiam) (citing collected cases from First, Fifth, Ninth, Tenth, and Eleventh Circuits).

310 See *Racine Charter One*, 424 F.3d at 684 (citing collected Seventh Circuit cases requiring proof of irrationality or illegitimate animus).

311 *Engquist v. Or. Dep't of Agric.*, 553 U.S. 591, 603–04 (2008).

312 *Id.* at 607; see also *Papas v. Leonard*, 554 F. App'x 764, 764 (9th Cir. 2013) (“[T]he ‘class-of-one’ theory is not cognizable with regard to discretionary actions.”); *Towery v. Brewer*, 672 F.3d 650, 660 (9th Cir. 2012) (per curiam) (quoting *Engquist*) (“The class-of-one doctrine does not apply to forms of state action that ‘by their nature involve discretionary decisionmaking based on a vast array of subjective, individualized assessments.’”).

313 Cf. Alex M. Hagen, *Mixed Motives Speak in Different Tongues: Doctrine, Discourse, and Judicial Function in Class-of-One Equal Protection Theory*, 58 S.D. L. REV. 197, 226 (2013) (“*Engquist* was not so narrowly written, nor was it intended to be so narrowly read.”).

314 Robert C. Farrell, *The Equal Protection Class of One Claim: Olech, Engquist, and the Supreme Court's Misadventure*, 61 S.C. L. REV. 107, 131 (2009).

315 543 F.3d 891 (7th Cir. 2008).

316 *Id.* at 900.

the challenge is doomed to failure and a class-of-one equal protection claim is foreclosed for the same reason.³¹⁷ Other courts have agreed and rejected class-of-one attacks on the exercise of prosecutorial discretion.³¹⁸

Cases holding that class-of-one claims are not cognizable with respect to the exercise of prosecutorial discretion should have been fatal to Gupta's equal protection claim and should be fatal to subsequent similar equal protection claims asserted by respondents in SEC administrative proceedings. A decision by the SEC (or CFTC) to proceed in an administrative forum rather than in a judicial forum is a clear analog to the exercise of prosecutorial discretion in criminal cases. Such decisions are based on a multiplicity of discretionary factors, many of which were formally identified by the Division in the guidance it released in May 2015 and informally acknowledged by the Division even earlier.³¹⁹

The specific facts concerning the SEC's initial decision to issue an OIP against Gupta and utilize an administrative forum provide an excellent illustration of the broadly discretionary nature of that decision-making process. It appears that the SEC was motivated in large part by the goal of investor protection when it decided to pursue an action against Gupta, who was serving on the boards of three public companies—including Procter & Gamble and American Airlines parent AMR Corp. Gupta resigned from these boards after the OIP was filed.³²⁰

But why did the SEC initially file administratively against Gupta, rather than in federal court? At the time that the SEC filed the OIP the criminal action against Gupta was in the pre-indictment stage. Parallel civil and criminal proceedings are common,³²¹ and the SEC

317 *Id.*

318 *See, e.g.,* Wade v. Collier, 783 F.3d 1081, 1089 n.5 (7th Cir. 2015) (remarking that plaintiff's "class-of-one equal protection claim is not a good fit in the context of a harm caused by the State's Attorney's Office's exercise of its prosecutorial discretion"); Donahoe v. Arpaio, 869 F. Supp. 2d 1020, 1073–74 (D. Ariz. 2012) (rejecting class-of-one challenge arising from discretionary prosecutorial decisions).

319 *See, e.g.,* Jenna Greene, *The SEC's on a Long Winning Streak; Criticism Rises over the Agency's In-House Forum*, NAT'L L.J. (Jan. 19, 2015) (listing factors identified by Andrew Ceresney, Director, SEC Enforcement Division).

320 Michael Rothfeld, Susan Pulliam & Jean Eaglesham, *Focus on Goldman Ex-Director*, WALL ST. J., Sept. 21, 2011, at C1.

321 Derelle Janey, *Parallel Proceedings: Staying the Civil Action*, N.Y. L.J. (Sept. 2, 2014), http://www.gottliebgonordon.com/site/files/parallel_proceedings.pdf; MORRISON & FOERSTER, LLP, *A Primer on SEC Investigations and Enforcement Actions Relating to Financial Reporting and Accounting Cases*, 11 (2014), <http://media.mofo.com/files/Uploads/Images/140122-SEC-Investigation-Handbook.pdf> ("In cases in which criminal activity has

and DOJ have a long history of cooperation with one another,³²² but a parallel civil proceeding can jeopardize a criminal action. Defendants can obtain discovery in an SEC civil action that is not available under the Federal Rules of Criminal Procedure, while simultaneously denying the government reciprocal discovery by invoking the Fifth Amendment privilege against self-incrimination and compromising cooperating witnesses in the criminal case.³²³ The U.S. Attorney's Office can seek to stay a parallel civil action commenced by the SEC, but whereas such stay motions used to be regularly granted, in recent years they have been frequently denied.³²⁴ And Judge Rakoff has not been sympathetic to motions to stay SEC civil actions.³²⁵

The factors noted above likely were dispositive in the SEC's decision to file an OIP against Gupta. The SEC, simultaneously sensitive to investor protection and the litigation strategy of the U.S. Attorney for the Southern District of New York, opted for the proceeding that posed the least risk of interference with the criminal trial of Rajaratnam, as well as any future criminal case against Gupta.³²⁶ An administrative proceeding would have involved significantly less discovery than would have a civil action in federal court, and thus it would have been considerably less likely to jeopardize the criminal prosecutions. In short, as noted by Professor J. Robert Brown, Jr., "the decision to bring an administrative proceeding rather than an injunctive proceeding was eminently reasonable and entirely appropriate given the competing pressures."³²⁷

occurred, the SEC will often work in parallel with the Department of Justice or, less frequently, state criminal authorities.").

322 Eli J. Richardson, *Patterns in Parallel Proceedings: SEC Actions, DOJ Tools*, LAW360 (Jan. 17, 2012, 1:18 PM), <http://www.law360.com/articles/298489/patterns-in-parallel-proceedings-sec-actions-doj-tools>.

323 Walter P. Loughlin, *Parallel Civil and Criminal Proceedings*, PRACTICAL LITIGATOR, Mar. 2011, at 19, 22–23; Zweifach & Creizman, *supra* note 288, at 9. *See also* Braden Campbell, *Discovery Halted in SEC Hacking Suit Amid Criminal Case*, LAW360 (Feb. 1, 2016, 8:08 PM), <http://www.law360.com/articles/753300/discovery-halted-in-sec-hacking-suit-amid-criminal-case> (reporting that New Jersey federal judge stayed discovery in SEC civil action because such discovery could have undermined two related criminal cases).

324 Zweifach & Creizman, *supra* note 288, at 9. *See also* Stewart Bishop, *Once Assured, An SEC Stay as DOJ Acts is No Longer A Lock*, LAW360 (Oct. 31, 2016, 5:08 PM), <http://www.law360.com/articles/857032/once-assured-an-sec-stay-as-doj-acts-is-no-longer-a-lock> (noting that some federal judges "are increasingly eschewing blanket civil discovery stays").

325 *See, e.g.*, SEC v. Saad, 229 F.R.D. 90, 92 (S.D.N.Y. 2005) (Rakoff, J.) (denying government application for stay of discovery in SEC enforcement action which had been filed in tandem with parallel criminal case).

326 Rothfeld, Pulliam & Eaglesham, *supra* note 320.

327 J. Robert Brown, Jr., *Gupta, Business Roundtable, and the Need for a New Approach at the SEC*, [THERACETOTHEBOTTOM.ORG](http://www.THERACETOTHEBOTTOM.ORG) (Sept. 27, 2011, 6:00 AM),

The foregoing discussion demonstrates why class-of-one equal protection claims asserted by defendants in SEC administrative proceedings should fail. Choices by the SEC (or CFTC) to proceed administratively are the product of broadly discretionary decision-making and as such should be insulated from attack, absent a showing of invidious discrimination. Gupta's case, which no doubt inspired subsequent defendants to assert equal protection claims, is a very good example of why such claims are defective.

C. Seventh Amendment

A third common line of attack is that SEC and CFTC administrative proceedings deny the right to a jury trial in violation of the Seventh Amendment.³²⁸ Gupta asserted this claim in his federal action against the SEC³²⁹ and numerous respondents in SEC proceedings have followed his lead.³³⁰ It is true that respondents in such proceedings are denied the right to a jury trial,³³¹ and the availability of a jury can be particularly beneficial to a defendant in a complex securities fraud case.³³² Nevertheless, this denial does not violate the Seventh Amendment, for the reasons explained below.

The Supreme Court has addressed the question of congressional power to provide for non-jury trials in a series of cases that split into two categories. In the first category, Congress has created a statutory cause of action and provided that assertion of the claim must proceed in a specialized statutory proceeding or in a specialized tribunal, such as an administrative tribunal utilizing ALJs. The Supreme Court has never held that the Seventh Amendment guarantees the right to a ju-

<http://www.theracetothetbottom.org/securities-issues/gupta-business-roundtable-and-the-need-for-a-new-approach-at.html>. *But see* Michael Dvorak, Note, *SEC Administrative Proceedings and Equal Protection "Class of One" Challenges: Evaluating Concerns About SEC Forum Choices*, 2015 COLUM. BUS. L. REV. 1195, 1218 (2015) (arguing that defendants like Gupta should be able to challenge the SEC's choice of forum under a class-of-one equal protection argument).

³²⁸ The Seventh Amendment provides: "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved. . . ." U.S. CONST. amend. VII.

³²⁹ *Gupta v. SEC*, 796 F. Supp. 2d 503, 507 (S.D.N.Y. 2011).

³³⁰ *See, e.g.*, Complaint for Declaratory and Injunctive Relief at 2, 3, 18–20, *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294 (N.D. Ga. 2015) (No. 1:15-cv-02512-LMM) (alleging that administrative proceedings violate the constitutional right to a trial by jury).

³³¹ *See, e.g.*, *Bebo v. SEC*, 799 F.3d 765, 768 (7th Cir. 2015) (explaining that a respondent "has no right to a jury trial before the SEC").

³³² Peter J. Henning, *The S.E.C.'s Use of the "Rocket Docket" is Challenged*, N.Y. TIMES: DEALBOOK (Aug. 25, 2014, 11:48 AM), http://dealbook.nytimes.com/2014/08/25/the-s-e-c-s-use-of-the-rocket-docket-is-challenged/?_r=0.

ry trial in a proceeding conducted by an administrative tribunal.³³³ In the second category, which is of minimal concern here, Congress has provided for the statutory right to be enforced in federal district court.³³⁴

The leading case controlling the first category is *Atlas Roofing Co. v. Occupational Safety & Health Review Commission*.³³⁵ In *Atlas Roofing* petitioners alleged that the Occupational Safety and Health Act of 1970 (“OSH Act”)³³⁶ violates the Seventh Amendment because it provides for civil penalties for OSH Act violations to be levied by the Secretary of Labor and contested assessed penalties to be adjudicated by the Occupational Safety and Health Review Commission (“OSHRC”).³³⁷ The Supreme Court unanimously rejected this argument. The Court held:

At least in cases in which “public rights” are being litigated—e.g. cases in which the Government sues in its sovereign capacity to enforce public rights created by statutes within the power of Congress to enact—the Seventh Amendment does not prohibit Congress from assigning the fact finding function and initial adjudication to an administrative forum in which the jury would be incompatible.³³⁸

Atlas Roofing relied on *National Labor Relations Board v. Jones & Laughlin Steel Corp.*,³³⁹ a New Deal-era case in which the Supreme Court first encountered a Seventh Amendment objection to administrative adjudication. In *Jones & Laughlin* the Court upheld a provision of the National Labor Relations Act (“NLRA”)³⁴⁰ empowering the NLRB to award back pay as a remedy for unfair labor practices.³⁴¹ *Atlas Roofing* also relied on *Curtis v. Loether*,³⁴² decided in 1974, in which the Supreme Court explained that *Jones & Laughlin* “stands for the proposition that the Seventh Amendment is generally inapplicable to administrative proceedings”³⁴³ Collectively, the three cases establish that Congress has wide latitude in creating administrative mechanisms for adjudicating statutory or public rights, and the Seventh

333 Paul K. Sun, Jr., Note, *Congressional Delegation of Adjudicatory Power to Federal Agencies and the Right to Trial by Jury*, 1988 DUKE L.J. 539, 545.

334 See text accompanying notes 366–373 *infra*.

335 430 U.S. 442 (1977).

336 Occupational Safety and Health Act, 29 U.S.C. §§ 651–678 (1970).

337 *Atlas Roofing*, 430 U.S. at 450.

338 *Id.*

339 301 U.S. 1 (1937).

340 National Labor Relations Act, 29 U.S.C. §§ 151-52 (2012).

341 *Jones & Laughlin*, 301 U.S. at 21.

342 415 U.S. 189 (1974).

343 *Id.* at 194.

Amendment does not compel a jury trial in these situations.³⁴⁴ The Supreme Court's resolution of the three cases—particularly *Atlas Roofing*—has drawn criticism,³⁴⁵ but the Court has never retreated from their primary holdings.

Atlas Roofing strongly suggested—but did not hold—that Congress is free to assign fact finding and initial adjudication to an administrative forum only where a public right is involved.³⁴⁶ In a subsequent case, *Granfinanciera, S.A. v. Nordberg*,³⁴⁷ the Court defined a public right as a right arising between the federal government and others, or one where Congress, acting for a valid legislative purpose pursuant to its constitutional powers under Article I, has created a “seemingly ‘private right’ that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary.”³⁴⁸

The Supreme Court's jurisprudence on the public-private distinction has been described as a “confusing morass”³⁴⁹ and the precise contours of the two categories remain in dispute.³⁵⁰ The enforcement of federal securities laws would appear to be an obvious example of the enforcement of public rights,³⁵¹ but the absence of a bright divid-

344 CHARLES ALAN WRIGHT ET AL., 9 FED. PRAC. & PROC. CIV. § 2302.2 (3d ed. database updated Apr. 2016).

345 See, e.g., Roger W. Kirst, *Administrative Penalties and the Civil Jury: The Supreme Court's Assault on the Seventh Amendment*, 126 U. PA. L. REV. 1281, 1338 (1978) (“The attempt in *Atlas* to carve out a new exception to the [S]eventh [A]mendment to permit administrative fact-finding in public rights cases poses a serious threat to a fundamental guarantee of the Bill of Rights.”).

346 Cf. *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 458 (1977) (“Our prior cases support administrative factfinding in only those situations involving ‘public rights,’ e.g., where the Government is involved in its sovereign capacity under an otherwise valid statute creating enforceable public rights.”).

347 *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989).

348 *Id.* at 54 (quoting *Thomas v. Union Carbide Agric. Prod. Co.*, 473 U.S. 568, 586, 593–94 (1985)). See also *Stern v. Marshall*, 131 S. Ct. 2594, 2613 (2011) (“[W]hat makes a right ‘public’ rather than private is that the right is integrally related to particular federal government action.”).

349 Mila Sohoni, *Agency Adjudication and Judicial Nondelegation: An Article III Canon*, 107 NW. U. L. REV. 1569, 1584 (2013).

350 *Id.* at 1587. See also Mark I. Greenberg, *The Right to Jury Trial in Non-Article III Courts and Administrative Agencies After Granfinanciera v. Nordberg*, 1990 U. CHI. LEGAL F. 479, 481 (1990) (“[T]he Supreme Court has never provided a workable definition of public rights.”); Paul K. Sun, Jr., Note, *Congressional Delegation of Adjudicatory Power to Federal Agencies and the Right to Trial by Jury*, 1988 DUKE L.J. 539, 553 (“[T]he Court has offered no firm definition of public rights . . .”).

351 See, e.g., *Hill v. SEC*, 114 F. Supp. 3d 1297, 1314 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016) (“Because the SEC is acting as a sovereign in the performance of its executive duties when it pursues an enforcement action, the Court also agrees that this is a public rights case.”); *SEC v. Petrofunds, Inc.*, 420 F. Supp. 958, 960

ing line has provided some ammunition for parties asserting Seventh Amendment challenges to SEC and CFTC administrative enforcement. To date, those challenges have failed, whether asserted in court or in administrative proceedings.

One of the earliest cases to consider the Seventh Amendment argument in the context of CFTC administrative enforcement was *Myron v. Hauser*.³⁵² In that case, decided in 1982, the Eighth Circuit relied on *Atlas Roofing* to reject an argument that the award by the CFTC of reparations following an administrative hearing by a CFTC ALJ violated the Seventh Amendment.³⁵³ In the course of holding that no Seventh Amendment violation had occurred, the Eighth Circuit rejected the argument that the CFTC's reparations procedures—which provide a simplified mechanism for the resolution of customer claims against commodity brokers³⁵⁴—do not involve public rights. The court noted that even though it was the customer who was awarded reparations, the case in a functional sense was between the government and the regulated commodity options broker.³⁵⁵ One year later, in *Swiers v. Rosenthal & Co.*,³⁵⁶ a CFTC ALJ also rejected a claim that CFTC reparations proceedings violate the Seventh Amendment.

Arguments that administrative enforcement by the SEC violates respondents' Seventh Amendment rights have been similarly unsuccessful. Both the SEC (acting as the first level of appeal from an ALJ

(S.D.N.Y. 1976) (“Indeed, the entire purpose and thrust of an SEC enforcement action is expeditiously to safeguard the public interest by enjoining recurrent or continued violations of the securities acts.”). In *Petrofunds*, the federal district court granted the SEC's motion to strike defendant's demand for a jury trial. *Id.* Cf. *SEC v. Kopsky*, 537 F. Supp. 2d 1023, 1028 (E.D. Mo. 2008) (denying defendants' motion to strike SEC's demand for a jury trial).

352 673 F.2d 994 (8th Cir. 1982). The same argument was raised four years earlier in *Rosenthal & Co. v. Bagley*, 581 F.2d 1258 (7th Cir. 1978), but in that case the Seventh Circuit declined to decide the issue because plaintiff had failed to exhaust its administrative remedies by appealing from an adverse order of the CFTC in the reparations proceeding being challenged. *Id.* at 1259, 1261.

353 *Myron*, 673 F.2d at 1003 (“*Atlas Roofing* refutes [plaintiff's] seventh amendment challenge.”).

354 See Commodity Futures Trading Commission, *Reparations Program*, <http://www.cftc.gov/ConsumerProtection/ReparationsProgram/index.htm> (explaining the reparations procedures).

355 *Myron*, 673 F.2d at 1004–05. But see Jerry W. Markham, *The Seventh Amendment and the CFTC Reparations Proceedings*, 68 IOWA L. REV. 87, 120–22 (1982) (arguing that CFTC reparations proceedings involve disputes between private parties).

356 *Commod. Fut. L. Rep. (CCH)* ¶21,817, at 27,396 (C.F.T.C. 1983).

decision)³⁵⁷ and Article III judges³⁵⁸ have cited *Atlas Roofing* and rejected Seventh Amendment arguments.

In *Hill v. SEC*,³⁵⁹ Charles Hill—the respondent in an SEC administrative proceeding—sued the SEC in federal district court in 2015 alleging constitutional violations, including the denial of his Seventh Amendment right to a jury trial. Hill conceded that the SEC’s enforcement action against him involved a public right,³⁶⁰ but he argued that under *Atlas Roofing* and *Granfinanciera* the public right must be new or novel to be excluded from the Seventh Amendment’s ambit and the SEC’s claims against him were neither. According to Hill, Dodd-Frank did not create any cause of action. Rather, it simply authorized the SEC to institute in an administrative forum a pre-existing type of enforcement action that previously had been the exclusive province of Article III courts.³⁶¹ Additional respondents in SEC administrative proceedings have advanced the same argument.³⁶²

Both *Atlas Roofing* and *Granfinanciera* contain language that at first glance appears to support the foregoing argument. In *Atlas Roofing* the Supreme Court stated that when Congress creates *new* statutory public rights it may assign their adjudication to an administrative agency without violating the Seventh Amendment.³⁶³ And in *Granfinanciera* the Court stated that Congress may devise *novel* causes of action involving public rights free from the strictures of the Seventh Amendment if it assigns their adjudication to administrative tribunals.³⁶⁴ Nevertheless, the district court in *Hill* properly rejected plaintiff’s argument on the basis that it elevates form over substance and misconstrues the Supreme Court’s language. The district court stated: “Congress does not tie its hands when it initially creates a cause of action. Plaintiff cites no authority which specifically holds that Congress may not change its mind and reassign public rights to administrative proceedings.”³⁶⁵

357 Vladlen “Larry” Vindman, Admin. Proc. File No. 3-11247, Rel. No. 8679, at *11 (Apr. 14, 2006).

358 *Hill v. SEC*, 114 F. Supp. 3d 1297, 1315–16 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016).

359 *Id.*

360 *Id.* at 1314.

361 *Id.*

362 *See, e.g.*, Complaint for Declaratory and Injunctive Relief at 19, *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294 (N.D. Ga. 2015) (No. 1:15-cv-02512-LMM) (alleging that Dodd-Frank did not create a new cause of action).

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

364 *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 51 (1989).

365 *Hill*, 114 F. Supp. 3d at 1315.

As noted above, there is a second Supreme Court line of Seventh Amendment jurisprudence, covering situations where Congress has provided for a statutory right to be enforced in federal court. Some respondents in SEC administrative proceedings have erroneously relied on this line of cases to bolster their Seventh Amendment claims. In particular, respondents have erroneously relied on *Tull v. United States*.³⁶⁶ In that case the government successfully sued a real estate developer for violations of the Clean Water Act³⁶⁷ in federal court. The developer alleged a violation of his Seventh Amendment rights after the district judge denied his timely demand for a jury trial.³⁶⁸ On appeal the Supreme Court held that the Seventh Amendment grants the right to a jury trial on all issues relating to liability for civil penalties, but not on the amount of penalties, when the federal government seeks relief in federal court under the Clean Water Act.³⁶⁹

Tull is inapposite to the use by the SEC and CFTC of administrative enforcement, because it sets forth a rule applicable only in the second line of Supreme Court cases. That is, *Tull* merely stands for the proposition that when the federal government seeks to impose penalties under the Clean Water Act in a judicial forum, rather than in an administrative forum, the defendant is entitled to a jury trial on the issue of liability. *Tull* does not stand for the proposition that the Seventh Amendment prohibits the federal government from seeking the imposition of penalties under the Clean Water Act in an administrative forum, or the imposition of penalties under any other federal statute in an administrative forum.³⁷⁰ The Clean Water Act expressly authorizes the imposition of administrative penalties,³⁷¹ that provision has never been deemed unconstitutional, and the Environmental Protection Agency (“EPA”) annually files exponentially more admin-

366 481 U.S. 412 (1987). *See, e.g.*, Complaint for Declaratory and Injunctive Relief at 18–19, *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294 (N.D. Ga. 2015) (No. 1:15-cv-02512-LMM) (citing *Tull*).

367 Clean Water Act, 33 U.S.C. §§ 1251–1376 (2012).

368 *Tull*, 481 U.S. at 415.

369 *Id.* at 425–27.

370 The U.S. Chamber of Commerce recently issued a report criticizing the SEC’s expanded use of APs and asserting that “[t]he Supreme Court has held that a defendant is entitled to a jury every time the government demands a civil penalty.” *See* U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 17. Whether or not this is true, it has no bearing on the imposition of penalties in an administrative forum, for the reasons explained above.

371 Clean Water Act, 33 U.S.C. § 1319(g) (2012); *Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found., Inc.*, 484 U.S. 49, 57–58 n.2 (1987) (“[T]he most recent Clean Water Act amendments permit EPA to assess administrative penalties without judicial process on any person who ‘has violated’ the provisions of the Act.”).

istrative order penalty actions than it does civil judicial complaints. In fiscal year 2015 the EPA filed 108 civil judicial complaints and 1400 administrative penalty complaints.³⁷²

In short, nothing about *Tull* supports a Seventh Amendment challenge to the use by the SEC and CFTC of administrative enforcement. Indeed, the Supreme Court, citing *Atlas Roofing*, reaffirmed in a footnote in *Tull* that “the Seventh Amendment is not applicable to administrative proceedings.”³⁷³

D. Article II

Respondents asserting constitutional challenges to the SEC’s use of administrative proceedings have made their best arguments under Article II of the U.S. Constitution. The arguments take two forms. First, respondents argue that SEC ALJs are protected by at least two layers of removal protection, in violation of Article II. Second, respondents argue that SEC ALJs are not appointed by the President, the courts, or department heads, in violation of the Appointments Clause of Article II. Those two arguments are examined below. As will be seen, while the arguments are applicable to CFTC administrative proceedings,³⁷⁴ there are important differences between the SEC RoP and CFTC RoP which render the constitutional analysis somewhat different for the two agencies.

1. Multiple Layers of Removal Protection

The first argument based on Article II stems from the Supreme Court’s 2010 decision in *Free Enterprise Fund v. Public Company Accounting Oversight Board* (“*Free Enterprise*”).³⁷⁵ In that case the Court held that the Public Company Accounting Oversight Board (“PCAOB”) was improperly constituted because its members, although acting with the powers of executive officers, were insulated by statute from the President by two layers of limitations on removal. There were two layers because PCAOB members could only be removed for cause³⁷⁶

372 ENV’T PROT. AGENCY, ENFORCEMENT ANNUAL RESULTS NUMBERS AT A GLANCE FOR FISCAL YEAR (FY) 2015, <https://www.epa.gov/enforcement/enforcement-annual-results-numbers-glance-fiscal-year-fy-2015>.

373 *Tull*, 481 U.S. at 418 n.4. See also Gregory T. Bolan, Jr. & Joseph C. Ruggieri, Exchange Act Release No. 877, at *4 (ALJ Sept. 14, 2015) (citing *Tull* in rejecting Seventh Amendment challenge to SEC administrative proceeding).

374 Kaufman & Forero, *supra* note 98 (“The same challenge [regarding two layers of protection] can be made regarding a CFTC administrative proceeding.”).

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

376 *Id.* at 486.

and those individuals who could remove the members—the SEC Commissioners—could also only be removed for cause.³⁷⁷ The Supreme Court had previously held that one level of for-cause removal protection was constitutional,³⁷⁸ but in *Free Enterprise* it held that a second layer was one too many for the PCAOB.³⁷⁹

Respondents in SEC administrative proceedings have seized on the holding of *Free Enterprise* to argue that such proceedings are unconstitutional because SEC ALJs are insulated from removal by the President by at least two layers of protection.³⁸⁰ ALJs can only be removed for cause by SEC Commissioners,³⁸¹ with the consent of the Merit Systems Protection Board (“MSPB”),³⁸² and, as noted above, the Supreme Court stated in *Free Enterprise* that SEC Commissioners can only be removed for cause. Respondents’ argument is superficially appealing but ultimately unpersuasive. To date, those federal district courts which have examined the argument have either expressly rejected it³⁸³ or stated in dicta that the argument is defective.³⁸⁴

Respondents’ argument is defective for multiple reasons and those courts which have rejected it have been correct.³⁸⁵ First, the Supreme Court did not decide in *Free Enterprise* that SEC Commis-

377 *Id.* at 487.

378 *See* *Humphrey’s Ex’r v. United States*, 295 U.S. 602 (1935).

379 *Free Enter.*, 561 U.S. at 492.

380 *See, e.g.,* *Duka v. SEC*, 124 F. Supp. 3d 287, 288 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016).

381 *Duka v. SEC*, 103 F. Supp. 3d 382, 387 (S.D.N.Y. 2015), *abrogated on other grounds by* *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (“All ALJs, including SEC ALJs, are removable from employment by their respective agency heads (in this case, the [SEC]), but only for ‘good cause.’”). The removal of federal ALJs is rare; between 1946 and 1992 only five ALJs were removed from federal agencies. VANESSA K. BURROWS, CONG. RESEARCH SERV., RL34607, ADMINISTRATIVE LAW JUDGES: AN OVERVIEW 9 (2010). In contrast, fifteen Article III judges were impeached during the period 1803–2010. *Impeachments of Federal Judges*, FED. JUD. CTR., http://www.fjc.gov/history/home.nsf/page/judges_impeachments.html (last visited June 15, 2016). Three of the impeached judges resigned before the Senate’s impeachment trials concluded. *Id.* Four of the impeached judges were acquitted by the Senate. *Id.*

382 Barnett, *supra* note 18, at 800. The MSPB is an independent federal agency which handles appeals by federal employees of adverse employment actions. *Id.* Pursuant to 5 U.S.C. § 7521, such an action may be taken against an ALJ only for good cause established and determined by the MSPB. *Id.* at 814–15.

383 *See, e.g.,* *Duka*, 124 F. Supp. 3d at 289–90 (declining to reconsider its previous holding that there is no basis for concluding the restrictions on SEC ALJ removal infringes presidential authority).

384 *See* *Gray Fin. Grp., Inc. v. SEC*, 166 F. Supp. 3d 1335, 1354 n.10 (N.D. Ga. 2015), *vacated on other grounds by* *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) (expressing serious doubts that two-layer removal protection for SEC ALJs is unconstitutional).

385 *Cf.* David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1191 (2016) (identifying the *Free Enterprise* argument as respondents’ best constitutional argument).

sioners enjoy for-cause removal protection. Rather, the Court simply accepted the parties' stipulation that Commissioners can be removed only for inefficiency, neglect of duty, or malfeasance in office,³⁸⁶ just as lower courts have implied such protection.³⁸⁷ The foregoing implication is dubious. There is no for-cause removal provision in the federal securities laws and there is very good reason to think this was a deliberate choice by Congress.

The constitutional status of independent federal agencies stems from the 1935 case of *Humphrey's Executor v. United States*.³⁸⁸ That case arose when President Franklin D. Roosevelt attempted to remove an FTC Commissioner based on policy disagreements between the two men.³⁸⁹ The Court rejected this attempt and held that Congress can, under certain circumstances, create independent agencies run by principal officers appointed by the President, whom the President may remove only for good cause.³⁹⁰ In so holding, the Court endorsed the idea that when Congress creates an agency—such as the FTC—with for-cause removal protection it “intends for the agency to be totally free from presidential influence, aside from the President’s role in appointments.”³⁹¹

The SEC was established in 1934 by Section 4 of the Securities Exchange Act (“Exchange Act”),³⁹² one year before *Humphrey's Executor* was decided. When it was established, it would have been unconstitutional to make SEC Commissioners removable only for cause, under the Supreme Court’s pre-*Humphrey's Executor* precedent.³⁹³ But at no time since *Humphrey's Executor* was decided has Congress amended the Exchange Act to create a for-cause removal provision, even though the statute has been amended twelve times since then.³⁹⁴ Moreover, in the years since *Humphrey's Executor* was decided Con-

386 See *Free Enter.*, 561 U.S. at 487; Aziz Z. Huq, *Removal as a Political Question*, 65 STAN. L. REV. 1, 15 (2013) (“[T]he Court followed the parties’ briefs in assuming that SEC members could be removed by the President only for cause.”); Neomi Rao, *A Modest Proposal: Abolishing Agency Independence in Free Enterprise Fund v. PCAOB*, 79 FORDHAM L. REV. 2541, 2560 (2011) (“The parties stipulated that Commissioners could be removed only [for cause].”).

387 See Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies)*, 98 CORNELL L. REV. 769, 833 (2013) (noting that lower courts have assumed that SEC enjoys for-cause removal protection).

388 295 U.S. 602 (1935).

389 See *id.* at 618–19.

390 *Id.* at 630–32.

391 Datla & Revesz, *supra* note 387, at 779.

392 See 15 U.S.C. § 78d (1934).

393 See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 547 (2010) (Breyer, J., dissenting).

394 Datla & Revesz, *supra* note 387, at 834.

gress has created multiple agencies, some with express for-cause removal protection (such as the NLRB and the FERC) and some without such protection (such as the CFTC, the Equal Employment Opportunity Commission (“EEOC”), and the Federal Election Commission).³⁹⁵ One recent review concluded: “When properly viewed in context, the presence or absence of a removal provision looks more like a deliberate choice than a drafting error.”³⁹⁶

Overall, the reliance by respondents in SEC proceedings on *Free Enterprise* is misplaced for the initial reason that the Supreme Court did not decide that SEC Commissioners cannot be removed by the President without a judicially reviewable showing of good cause, and its acceptance of a stipulation concerning such removal protection is dubious. Justice Stephen Breyer asked in dissent: “How can the Court simply *assume* without deciding that the SEC Commissioners themselves are removable only ‘for cause?’”³⁹⁷ There is no satisfactory answer to this question, and as Professor Laurence Tribe observed, absent acceptance of the parties’ stipulation, the “majority’s entire house of cards collapses.”³⁹⁸

The second reason that respondents’ reliance on *Free Enterprise* is misplaced is that, assuming arguendo that SEC ALJs are protected by two layers of protection from removal, the Supreme Court did not establish a bright-line rule that two layers are always unconstitutional.³⁹⁹ Rather, as stated by the majority, the only issue in the case was “whether Congress may deprive the President of adequate control over the [PCAOB]”⁴⁰⁰ The Court held that two layers were unconstitutional in the case of the PCAOB because its members exer-

395 *Id.*

396 *Id.*; accord David Moon, Note, *When Does Dual For-Cause Removal Protection Become Unconstitutional? Exploring the Scope of Free Enterprise Fund v. Public Company Accounting Oversight Board*, 2013 WIS. L. REV. 875, 889–90 (“[T]here is a strong historical argument that Congress specifically intended that SEC members be removable *at will* by the President.”).

397 *Free Enter.*, 561 U.S. at 545 (Breyer, J., dissenting).

398 Laurence H. Tribe, *Peek-A-Boo: Justice Breyer, Dissenting*, 128 HARV. L. REV. 498, 505 (2014) (“[T]he majority went out of its way to decide the case on the artificial assumption that the Commissioners of the SEC cannot be removed by the President without a judicially reviewable showing of good cause. Without that assumption, the majority’s entire house of cards collapses.”).

399 *See, e.g., Free Enter.*, 561 U.S. at 536 (Breyer, J., dissenting) (“The Court fails to create a bright-line rule because of considerable uncertainty about the scope of its holding”); *Duka v. SEC*, 103 F. Supp. 3d 382, 393 (S.D.N.Y. 2015), *abrogated by Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (“*Free Enterprise* clearly did not establish, as *Duka* suggests, a categorical rule forbidding ‘two levels of “good-cause” tenure protection.’”).

400 *Free Enter.*, 561 U.S. at 508.

cised expansive enforcement,⁴⁰¹ regulatory,⁴⁰² and adjudicative authority,⁴⁰³ and two layers of protection deprived the President of control over the non-adjudicatory functions.⁴⁰⁴ The Court refused to consider the applicability of its holding to other federal employees because none of them were similarly situated to the members of the PCAOB.⁴⁰⁵

In *Free Enterprise*, the Supreme Court discussed the impact of its decision on ALJs. The dissenting opinion, authored by Justice Breyer and joined by three other Justices, noted that ALJs are insulated from removal by two layers of protection⁴⁰⁶ and asked: “Does every losing party before an ALJ now have grounds to appeal on the basis that the decision entered against him is unconstitutional?”⁴⁰⁷ The majority responded that its opinion did not decide whether federal ALJs are constitutional, for two reasons: (1) it is not clear that ALJs are officers of the United States, so as to raise the Article II issue, and (2) many ALJs perform adjudicative rather than enforcement or policymaking functions, or possess purely recommendatory powers.⁴⁰⁸

The Appointments Clause of Article II governs the appointment of all officers of the United States, who fall into two categories—principal and inferior. The former, most likely those who report directly to the President, must be nominated by the President and confirmed by the Senate.⁴⁰⁹ The latter are those whose work is directed and supervised by principal officers or officers of lesser importance.⁴¹⁰ Very few federal government personnel are either principal or inferior officers. Rather, almost all personnel are mere employees whose

401 *Id.* at 485 (“The Board is charged with enforcing the Sarbanes-Oxley Act, the securities laws, the Commission’s rules, its own rules, and professional accounting standards.”).

402 *Id.* (“[T]he Board may regulate every detail of an accounting firm’s practice . . .”).

403 *Id.* (“[T]he Board itself can issue severe sanctions in its disciplinary proceedings . . .”).

404 *Id.* at 508 (“The only issue in this case is whether Congress may deprive the President of adequate control over the Board, which is the regulator of first resort and the primary law enforcement authority for a vital sector of our economy. We hold that it cannot.”).

405 *Id.* at 506–08.

406 *Id.* at 542 (Breyer, J., dissenting).

407 *Id.* at 543 (Breyer, J., dissenting).

408 *Id.* at 507 n.10 (majority opinion); *see also* *Duka v. SEC*, 103 F. Supp. 3d 382, 394 (S.D.N.Y. 2015), *abrogated by* *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (“[T]he majority specifically excluded ALJs from the reach of its holding.”); Patricia L. Bellia, *PCAOB and the Persistence of the Removal Puzzle*, 80 GEO. WASH. L. REV. 1371, 1411 (2012) (“The *PCAOB* Court took pains to emphasize the narrowness of its holding—in particular, that the holding carried no implications for the civil service or for ALJs.”).

409 *Morrison v. Olson*, 487 U.S. 654, 670 (1988); *Buckley v. Valeo*, 424 U.S. 1, 132 (1976) (*per curiam*).

410 *See* *Edmond v. United States*, 520 U.S. 651, 663 (1997) (“[I]nferior officers’ are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate.”).

appointments are not controlled by the Appointments Clause.⁴¹¹ The SEC has consistently and vociferously argued in litigation concerning the constitutionality of its administrative proceedings that its ALJs are mere employees, rather than officers of the United States. As to this issue the SEC probably is fighting a losing battle.

The Supreme Court has never articulated a bright-line test for determining who can be properly identified as an inferior officer.⁴¹² In *Buckley v. Valeo*⁴¹³ the Court noted that inferior officers exercise significant authority pursuant to the laws of the United States.⁴¹⁴ In *Morrison v. Olson*⁴¹⁵ the Court applied a functional test based on multiple criteria, including removal by a higher executive branch official, limitations on duties, and limited jurisdiction.⁴¹⁶ More recently, in *Free Enterprise*, the Court endorsed the view that inferior officers have superiors who direct and supervise their work and who are appointed by the President with the Senate's consent.⁴¹⁷ But these are not definitive tests.

SEC ALJs probably are inferior officers, as opposed to mere employees. By September 2016 at least five federal district court decisions had so held,⁴¹⁸ on multiple grounds. First, SEC ALJs exercise significant authority. While they lack contempt power, they conduct trials—taking testimony and ruling on the admissibility of evidence, among other tasks—and are empowered to enforce compliance with discovery orders.⁴¹⁹ Second, the authority of SEC ALJs is at least equal

411 Raymond J. Lucia Cos., Inc., Securities Exchange Act Release No. 75837, Investment Company Act Release No. 31806, at 29 (Sept. 3, 2015), *pet. denied*, Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016).

412 See Neomi Rao, *Removal: Necessary and Sufficient for Presidential Control*, 65 ALA. L. REV. 1205, 1244 (2014) (“The Court has struggled with articulating a test for who can be properly identified as an inferior officer.”).

413 424 U.S. 1 (1976).

414 *Id.* at 126.

415 487 U.S. 654 (1988).

416 *Id.* at 671–72 (identifying potential removal by a higher executive branch official, limited duties, and limited jurisdiction as factors leading to conclusion that independent counsel is an inferior officer).

417 *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 510 (2010).

418 *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1316 (N.D. Ga. 2015); *Duka v. SEC*, 124 F. Supp. 3d 287, 289 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016); *Hill v. SEC*, 114 F. Supp. 3d 1297, 1316 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016); *Gray Fin. Grp., Inc. v. SEC*, 166 F. Supp. 3d 1335, 1353 (N.D. Ga. 2015), *vacated on other grounds by Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016); *Timbervest, LLC v. SEC*, No. 1:15-CV-2106-LMM, 2015 WL 7597428, at *11 (N.D. Ga. Aug. 4, 2015).

419 *Duka v. SEC*, 15 Civ. 357 (RMB) (SN), at *11 (S.D.N.Y. Sept. 17, 2015); *Duka v. SEC*, 124 F. Supp. 3d 287, 289 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016) (“SEC ALJs are ‘inferior officers’ because they exercise ‘significant authority

to that of thousands of other individuals who have been deemed to be inferior officers by the Supreme Court. As noted by Professor Kent Barnett, “[t]he Court has held that district-court clerks, thousands of clerks within the Treasury and Interior Departments, an assistant surgeon, a cadet-engineer, election monitors, federal marshals, military judges, Article I judges, and the general counsel for the Transportation Department are inferior officers.”⁴²⁰ Third, SEC ALJs’ positions are established by law, and their duties, salary, and means of appointment are specified by statute.⁴²¹

In August 2016, in *Raymond J. Lucia Cos. v. SEC*,⁴²² the D.C. Circuit became the first federal appellate court to hold that SEC ALJs are employees, rather than inferior officers, and therefore their appointments are constitutional.⁴²³ In reaching its decision the D.C. Circuit relied heavily on the logic of its 2000 decision in *Landry v. FDIC*.⁴²⁴ In *Landry* the D.C. Circuit held that ALJs appointed by the Federal Deposit Insurance Corporation (“FDIC”) were employees despite exercising significant authority, because they had no statutory authority to issue final opinions.⁴²⁵ According to the court, a prior Supreme Court case, *Freytag v. Commissioner*,⁴²⁶ was not dispositive. In *Freytag* the Supreme Court held that special trial judges (“STJs”) for the U.S. Tax Court were inferior officers at least in part because they had authority to issue final decisions.⁴²⁷ *Landry* distinguished *Freytag* on the basis that whereas STJs had such authority, FDIC ALJs did not.⁴²⁸ There was a concurring opinion in *Landry*, which joined the court’s opinion except with regard to petitioner’s claim made under

pursuant to the laws of the United States.”). See also *Butz v. Economou*, 438 U.S. 478, 513 (1978) (“There can be little doubt that the role of the . . . administrative law judge . . . is ‘functionally comparable’ to that of a judge. His powers are often, if not generally, comparable to those of a trial judge: He may issue subpoenas, rule on proffers of evidence, regulate the course of the hearing, and make or recommend decisions.”).

420 Barnett, *supra* note 18, at 812.

421 *Duka v. SEC*, 15 Civ. 357 (RMB) (SN), at *11 (S.D.N.Y. Sept. 17, 2015).

422 No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016).

423 *Id.* at *3–7.

424 204 F.3d 1125 (D.C. Cir. 2000).

425 204 F.3d at 1134. Cf. *Ass’n of Am. R.R. v. U.S. Dep’t of Transp.*, 821 F.3d 19, 37 (D.C. Cir. 2016) (holding that arbitrator appointed by Surface Transportation Board qualified as officer of the United States because it was the arbitrator’s responsibility to render a final decision in disputes between Amtrak and the Federal Railroad Administration); Jody Godoy, *SEC Says Amtrak Ruling Doesn’t Apply in ALJ Challenge*, LAW360 (May 11, 2016, 4:03 PM), <http://www.law360.com/articles/795151/sec-says-amtrak-ruling-doesn-t-apply-in-alj-challenge>.

426 501 U.S. 868 (1991).

427 *Id.* at 882.

428 *Landry*, 204 F.3d at 1133–34.

the Appointments Clause. The concurrence argued that *Freitag's* discussion of the importance of the STJs' authority to issue final decisions was part of an alternative holding that was unnecessary to the outcome in *Freitag*.⁴²⁹ According to Professor Barnett, the concurrence in *Landry* had the better argument,⁴³⁰ and it is difficult to disagree with that assessment. The discussion of finality was part of an alternative holding.⁴³¹

Those post-*Landry* district courts which have held that SEC ALJs are inferior officers have found *Freitag's* primary holding to be controlling.⁴³² In *Lucia*, however, the D.C. Circuit followed *Landry*⁴³³ and applied *Freitag's* alternative holding to determine the status of SEC ALJs. The *Lucia* court noted that its analysis of *Landry's* applicability to SEC ALJs began and ended with ALJs' authority to issue final decisions.⁴³⁴ Because the initial decisions of SEC ALJs become final only when the SEC issues an order of finality,⁴³⁵ the D.C. Circuit concluded that the ALJs are mere employees.⁴³⁶

Lucia was wrongly decided for the same reason that *Landry* was mistaken. Both cases erroneously rely on *Freitag's* alternative holding. But even if SEC ALJs are inferior officers who are protected by two layers of for-cause removal protection, *Free Enterprise* still does not render them unconstitutional. As noted, in *Free Enterprise* the Supreme Court distinguished ALJs because many of them perform adjudicative rather than enforcement or policymaking functions, or because they possess recommendatory powers. The use of such a

429 *Id.* at 1142.

430 Barnett, *supra* note 18, at 813. See also Giles D. Beal IV, Note, *Judge, Jury, and Executioner: SEC Administrative Law Judges Post-Dodd Frank*, 20 N.C. BANKING INST. 413, 426 (2016) ("SEC ALJs perform almost identical duties to those performed by the STJs in *Freitag* . . ."). Cf. Choi & Pritchard, *supra* note 71, at 11 ("It is not clear how the Supreme Court would interpret *Freitag* in the context of the SEC's ALJs.").

431 See *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1315 (N.D. Ga. 2015) ("Only after it concluded STJs were inferior officers did *Freitag* address the STJ's ability to issue a final order: the STJ's limited authority to issue final orders was only an additional reason, not the reason.").

432 See, e.g., *Duka v. SEC*, 124 F. Supp. 3d 287, 289 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016); *Hill v. SEC*, 114 F. Supp. 3d 1297, 1317 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016). ("The Court finds that based upon the Supreme Court's holding in *Freitag*, SEC ALJs are inferior officers.").

433 Thomas J. Krysa, *A Key Victory for SEC in Battle Over Administrative Courts*, LAW360 (Aug. 15, 2016, 4:14 PM), <http://www.law360.com/articles/828028/a-key-victory-for-sec-in-battle-over-administrative-courts> ("The panel noted they were bound by the circuit's prior precedent, [*Landry*] . . .").

434 *Raymond J. Lucia Cos. v. SEC*, No. 15-1345, 2016 WL 4191191 at *4 (D.C. Cir. Aug. 9, 2016).

435 *Id.* at *5.

436 *Id.* at *3-7.

functional test is supported by Supreme Court precedent.⁴³⁷ And, in fact, SEC ALJs perform *only* adjudicative functions and they possess *only* the power to recommend a case disposition. While the SEC itself combines functions, SEC ALJs do not engage in enforcement or rulemaking. They only adjudicate.⁴³⁸ Likewise, the initial decision by an SEC ALJ is only a recommendation. The initial decision does not become final until the Commission acts, either by (1) conducting *de novo* review and issuing its own decision, or (2) issuing an order of finality because no party has appealed and the Commission has not decided to review *sua sponte* the ALJ's initial decision.⁴³⁹ Upon review, the Commission may affirm, reverse, modify, set aside, or remand for further proceedings, in whole or in part, any initial decision by an ALJ.⁴⁴⁰ And when the SEC conducts its *de novo* review it may hear additional evidence.⁴⁴¹

In the foregoing respects SEC ALJs are very different from the PCAOB members considered by the Supreme Court in *Free Enterprise*.⁴⁴² These differences suffice to remove SEC ALJs from any potential application of *Free Enterprise's* holding that PCAOB members cannot constitutionally be protected by dual layers of removal protec-

437 See, e.g., *Morrison v. Olson*, 487 U.S. 654, 689–90 (1988) (“The analysis contained in our removal cases is designed not to define rigid categories of those officials who may or may not be removed at will by the President, but to ensure that Congress does not interfere with the President’s exercise of the ‘executive power’ and his constitutionally appointed duty to ‘take care that the laws be faithfully executed’ under Article II.”).

438 See, e.g., *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 537 F.3d 667, 699 n.8 (D.C. Cir. 2008) (Kavanaugh, J., dissenting) (“ALJs perform only adjudicatory functions . . .”), *rev’d*, 561 U.S. 477 (2010); *Duka v. SEC*, 103 F. Supp. 3d 382, 395 (S.D.N.Y. 2015), *abrogated on other grounds by Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (“SEC ALJs perform solely adjudicatory functions, and are not engaged in policymaking or enforcement.”). *But cf.* *Barnett*, *supra* note 18, at 816 n.125 (“ALJs for a handful of agencies may (but rarely do) preside over formal rulemaking proceedings . . .”).

439 See, e.g., *Tilton v. SEC*, 824 F.3d 276, 279 (2d Cir. 2016) (“A presiding ALJ has authority to issue an initial decision, which may become final only by order of the Commission.”); *Raymond J. Lucia Cos.*, Admin. Proc. File No. 3-15006, Securities Exchange Act Rel. No. 75837, at 31 n.109 (Sept. 3, 2015), *pet. denied*, *Raymond J. Lucia Cos. v. SEC*, No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016) (noting that SEC ALJs’ initial decisions “do not become the final and effective decision of the agency without affirmative action on our part—specifically, our issuance of a finality order.”); *Timbervest v. SEC*, Civ. Action No. 1:15-CV-2106-LMM, 2015 WL 7599428, at *9 n.8 (N.D. Ga. Aug. 4, 2015) (“Because the regulations specify that the SEC itself must issue the final order essentially ‘confirming’ the initial order, the Court finds that SEC ALJs do not have final order authority.”).

440 *Raymond J. Lucia Cos.*, Admin. Proc. File No. 3-15006, Securities Exchange Act Rel. No. 75837, at 31 (Sept. 3, 2015), *pet. denied*, *Raymond J. Lucia Cos. v. SEC*, No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016).

441 *Id.*

442 See *Beal*, *supra* note 430, at 434 (“SEC ALJs do not exercise the broad executive powers that the PCAOB exercised, but, instead, act in a quasi-judicial role within the SEC.”).

tion.⁴⁴³ Several district courts have correctly used a functional approach to reach this conclusion, albeit some of them in dicta.⁴⁴⁴ However, the analysis might be different with regard to CFTC ALJs. Under the CFTC RoP, no Commission order is necessary for an ALJ's initial decision to become a final decision of the CFTC. Instead, if no appeal is taken and the Commission does not take a case for review on its own initiative, the initial decision becomes the decision of the Commission thirty days after service.⁴⁴⁵ In this respect, the initial decision by a CFTC is not a mere recommendation. Still, CFTC ALJs perform only adjudicative functions, and this characteristic alone should suffice to remove them from the ambit of *Free Enterprise's* holding.

2. *Appointment by a Department Head*

The second and much more persuasive argument advanced by respondents under Article II concerns the method of appointment for SEC ALJs. The Appointments Clause provides the exclusive means by which all officers of the United States may be appointed.⁴⁴⁶ The

443 See Jerome Nelson, *Administrative Law Judges' Removal "Only for Cause": Is that Administrative Procedure Act Protection Now Unconstitutional?*, 63 ADMIN. L. REV. 401, 412 (2011) ("The distinctions between PCAOB members and ALJs suggest that *Free Enterprise* should be inapplicable to the ALJs."). In the unlikely event that *Free Enterprise* is applicable to SEC ALJs and their tenure protection is unconstitutional, the most likely consequence would be undesirable—ALJs would become terminable at will. This was the outcome in *Free Enterprise*, where the Supreme Court saved the PCAOB by deeming the offending tenure provisions severable from the remainder of the Sarbanes-Oxley Act of 2002—which had created the board—and holding that PCAOB members could be removable at will going forward. See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 509 (2010); Stephen M. Juris & Barrett Johnson, *Forum over Substance? Respondent Rights and the SEC*, LAW360 (July 14, 2015, 10:30 AM), <http://www.law360.com/articles/678526/forum-over-substance-respondent-rights-and-the-sec> (arguing that if ALJs become terminable at will they will "wind up with even less insulation from institutional pressure").

444 See, e.g., *Duka v. SEC*, 124 F. Supp. 3d 287, 289–90 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016) (rejecting claim that two layers of removal protection for SEC ALJs violates Article II); *Duka v. SEC*, 103 F. Supp. 3d 382, 394 (S.D.N.Y. 2015), *abrogated on other grounds by Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016) (adopting functional test); *Gray Fin. Grp. v. SEC*, 166 F. Supp. 3d 1335, 1354 n.10 (N.D. Ga. 2015), *vacated on other grounds by Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016) ("[T]he Court declines to decide at this time whether the ALJs' two-layer tenure protections also violate Article II's removal protections. However, the Court has serious doubts that it does, as ALJs likely occupy 'quasi-judicial' or 'adjudicatory' positions, and thus these two-layer protections likely do not interfere with the President's ability to perform his duties.").

445 CFTC Rules of Practice, 17 C.F.R. § 10.84(c) (2010).

446 *Buckley v. Valeo*, 424 U.S. 1, 138–39 (1976); *Duka v. SEC*, 124 F. Supp. 3d 287, 289 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016).

Clause requires that inferior officers be appointed in one of three ways: by (1) the President, (2) the courts of law, or (3) heads of departments.⁴⁴⁷ The constitutional argument advanced by respondents in SEC proceedings is that SEC ALJs are inferior officers who have not been appointed in any of the three prescribed ways.

The second prong of the argument is uncontested—SEC ALJs are not appointed by the SEC Commissioners.⁴⁴⁸ The SEC has publicly conceded that its ALJs are hired by the SEC’s Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, and the OPM,⁴⁴⁹ with a possible exception for current Chief ALJ Brenda Murray, who may have been hired with input from the Commissioners.⁴⁵⁰

In contrast, the first prong of the argument has been vigorously contested by the SEC, which asserts that ALJs are mere employees, rather than inferior officers, and therefore the Appointments Clause does not apply at all. The SEC is correct that the Appointments Clause does not apply to employees.⁴⁵¹ Nevertheless, for the reasons explained above, the SEC probably is fighting a losing battle on the broader issue. By September 2016 at least five federal district court decisions—four of them by the same judge in Georgia—had expressly rejected the SEC’s position and held that SEC ALJs are inferior officers who were not appointed in any of the prescribed means, and therefore their appointments are unconstitutional.⁴⁵² By September

447 U.S. CONST., art. II, § 2, cl. 2.

448 *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1299 (N.D. Ga. 2015).

449 *See, e.g., Duka v. SEC*, 15 Civ. 357 (RMB) (SN), at *10 (S.D.N.Y. Sept. 17, 2015) (“There appears to be no dispute between Duka and the SEC that the ALJs in this matter are *not* appointed by the President or the SEC Commissioners.”); *Hill v. SEC*, 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016) (noting concession by SEC that ALJ in plaintiff Hill’s administrative proceeding was not appointed by an SEC Commissioner). OPM screens the candidates and must approve a selection or provide a list of candidates, but it does not hire ALJs for other agencies. *See* 5 C.F.R. §§ 930.203a, 930.201 (2016).

450 *See* J. Robert Brown, Jr., *Duka v. SEC and the Constitutionality of Administrative Law Judges (Part 7)*, THE RACETO THE BOTTOM.ORG (Aug. 27, 2015, 6:00 AM), <http://www.theracetothetobottom.org/home/duka-v-sec-and-the-constitutionality-of-administrative-law-j-5.html>.

451 *See, e.g., Freytag v. Commissioner*, 501 U.S. 868, 880 (1991) (“If we . . . conclude that a special trial judge is only an employee, petitioners’ challenge fails, for such ‘lesser functionaries’ need not be selected in compliance with the strict requirements of Article II.”).

452 *Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294, 1316–17 (N.D. Ga. 2015); *Duka v. SEC*, 124 F. Supp. 3d 287, 289 (S.D.N.Y. 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13, 2016); *Hill v. SEC*, 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016); *Gray Fin. Grp. v. SEC*, 166 F. Supp. 3d 1335, 1354 (N.D. Ga. 2015), *vacated on other grounds by Hill v. SEC*, 825 F.3d 1236 (11th Cir.

2016 no district court had accepted the SEC's argument. As noted, in August 2016 in *Lucia* the D.C. Circuit became the first appellate court to consider the merits of the SEC's argument, and the agency had a decisive victory. For the reasons explained above, the D.C. Circuit's decision probably is erroneous, and might carry little weight in other circuits.⁴⁵³

What are the likely consequences if the SEC's current appointment of its ALJs is determined to be unconstitutional? The SEC could solve its Article II problem by having the Commission reappoint its ALJs, because the Supreme Court held in *Free Enterprise* that the SEC is a department.⁴⁵⁴ Reappointment of the ALJs by the Commissioners as the head of the department would thus appear to provide an easy fix.⁴⁵⁵ Congress is not required to take any legislative action, because the SEC already has authority under Section 4(b) of the Exchange Act to appoint "officers . . . and other employees."⁴⁵⁶ In September 2015, the FTC, in *In re LabMD*,⁴⁵⁷ no doubt concerned about constitutional challenges to SEC ALJs, opted to ratify the appointment of an ALJ as both its chief ALJ and as the presiding ALJ in the *LabMD* AP, even though the FTC, like the SEC, maintains that its ALJs are mere employees.⁴⁵⁸ But to date the SEC has refused to

2016); *Timbervest v. SEC*, Civ. Action No. 1:15-CV-2106-LMM, 2015 WL 7597428, at *12 (N.D. Ga. Aug. 4, 2015).

453 See, e.g., Carmen Germaine, *SEC's Big DC Circ. Win Won't End In-House Clash*, LAW360 (Aug. 9, 2016, 10:00 PM), <http://www.law360.com/articles/826675/sec-s-big-dc-circ-win-won-t-end-in-house-clash> (concluding that *Lucia* will not resolve on-going debate about SEC APs). But cf. Mark Lanpher et al., *D.C. Circuit Upholds Constitutionality of SEC Administrative Proceedings*, SHEARMAN & STERLING, LLP (Aug. 16, 2016), <http://www.shearman.com/~media/Files/NewsInsights/Publications/2016/08/DC-Circuit-Upholds-Constitutionality-of-SEC-Administrative-Proceedings-LIT-081616.pdf> ("[T]he D.C. Circuit's opinion in *Lucia* has the potential to be an important precedent-setting decision.").

454 *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 511 (2010).

455 *Hill v. SEC*, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015), *vacated on other grounds*, 825 F.3d 1236 (11th Cir. 2016) ("[T]he ALJ's appointment could easily be cured by having the SEC Commissioners issue an appointment or preside over the matter themselves."); DAVIS POLK & WARDWELL, LLP, *Securities Litigation Update: Constitutional Challenges to SEC's Administrative Courts Gain Momentum* (Sept. 24, 2015), <http://www.davispolk.com/publications/securities-litigation-update-constitutional-challenges-sec%E2%80%99s-administrative-courts-gain/> ("[T]he SEC may cure the deficiency by having the SEC commissioners ratify the ALJs' appointments.").

456 See Kent Barnett, *The SEC's Inferiority Complex*, YALEJREG.COM (June 11, 2015), <http://www.yalejreg.com/blog/the-secs-inferiority-complex-by-kent-barnett/>.

457 *LabMD, Inc.*, No. 9357, 2015 WL 5608167, at *2 (F.T.C. Sept. 14, 2015).

458 Lawrence Elbaum, *Survey of Recent Motions to Enjoin SEC Administrative Proceedings*, N.Y. L.J. (Dec. 16, 2015), <http://www.newyorklawjournal.com/id=1202744911476/Survey-of-Recent-Motions-to-Enjoin-SEC-Administrative-Proceedings?slreturn=20160024165027> (noting that ratification "is perhaps a proactive step to moot any Appointments Clause challenges by respondents in the FTC's administrative forum"); Alison Frankel, *Unlike*

acknowledge either that there is a constitutional problem or that re-appointment should be the solution.⁴⁵⁹

The SEC's refusal to bend on the issue of whether its ALJs are inferior officers is understandable, because the potential ramifications of a concession (or appellate finding) of unconstitutionality are quite significant, both for the SEC and for other agencies. With respect to the latter, whereas most ALJs utilized by other federal agencies probably have been appointed by department heads, many—especially those utilized by agencies that are not departments (such as the CFPB and FERC)—likely have not been, and thus they too could be unconstitutional.⁴⁶⁰

With respect to the SEC, the potential ramifications can be analyzed in two major categories. The first category includes parties whose APs are final. It is unlikely that these parties will be able to successfully assert collateral attacks, pursuant to the principle of finality. Once a judgment becomes final, it typically cannot be attacked collaterally, absent extraordinary circumstances outweighing the presumption in favor of finality.⁴⁶¹ The absence of an adjudicator's authority to decide a case does not outweigh the presumption,⁴⁶² which

SEC, FTC Makes a Quick Fix to Ward Off ALJ Constitutional Challenges, ON THE CASE, REUTERS.COM (Sept. 16, 2015), <http://blogs.reuters.com/alison-frankel/2015/09/16/unlike-sec-ftc-makes-quick-fix-to-ward-off-alj-constitutional-challenges/>.

459 See Alison Frankel, *Why the SEC Can't Easily Solve Its Appointments Clause Problem with ALJs*, REUTERS: ON THE CASE (June 17, 2015), <http://blogs.reuters.com/alison-frankel/2015/06/17/why-the-sec-cant-easily-solve-appointments-clause-problem-with-aljs/> (noting that the SEC has avoided addressing potential consequences of proposed quick fix).

460 See Barnett, *supra* note 456; Aaron R. Crane & Justin A. Savage, *Securities: The Next Hot Topic in Environmental Law*, LAW360 (June 10, 2016, 4:10 PM), <http://www.law360.com/articles/805744/securities-the-next-hot-topic-in-environmental-law> ("EPA ALJs, for instance, do not seem to be appointed by a 'head of department' any more than are those at the SEC.").

461 See *Durfee v. Duke*, 375 U.S. 106, 114 (1963) ("To be sure, the general rule of finality of jurisdictional determinations is not without exceptions.").

462 *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 152 (2009) ("[S]ubject-matter jurisdiction . . . may not be attacked collaterally."); *Kontrick v. Ryan*, 540 U.S. 443, 455 n.9 (2004) (same); *Evans v. Bank of N.Y. Trust Co.*, 506 F. App'x 741, at *3 (10th Cir. 2012) (stating that once an order has become final on direct review, "the subject-matter jurisdiction of the court issuing the order can almost never be successfully raised."). The RESTATEMENT (SECOND) OF JUDGMENTS § 12 (1980) describes three exceptional circumstances in which a collateral attack on subject matter jurisdiction is permitted: "(1) The subject matter of the action was so plainly beyond the court's jurisdiction that its entertaining the action was a manifest abuse of authority; or (2) Allowing the judgment to stand would substantially infringe the authority of another tribunal or agency of government; or (3) The judgment was rendered by a court lacking capability to make an adequately informed determination of a question concerning its own jurisdiction and as a matter of procedural fairness the party seeking to avoid the judgment should have opportunity belatedly to attack the court's subject matter jurisdiction." The Supreme Court has not decided wheth-

suggests that “parties whose SEC ALJ-issued judgments are final will be unable to successfully attack them collaterally based on a determination that the ALJs’ appointments were unconstitutional.”⁴⁶³

The second category includes parties whose administrative determinations are not yet final. As of June 2015, the SEC had more than 100 contested proceedings open at various stages of the administrative process.⁴⁶⁴ These parties likely could successfully attack their eventual adjudications, based on a determination that their ALJs’ appointments were unconstitutional. Pursuant to a long line of Supreme Court precedent, a judgment entered by an improperly appointed adjudicator is void and should be set aside by any court having authority to review it. In *Ryder v. United States*,⁴⁶⁵ for example, the Court vacated several decisions by the Coast Guard Court of Military Review because the appointments of two of the court’s officers violated the Appointments Clause.⁴⁶⁶ Other cases are similar.⁴⁶⁷ In the foregoing cases, the Supreme Court remanded for re-trial by a properly appointed adjudicatory body. In the case of the SEC, there will be no such body, unless the SEC reappoints its ALJs. If the SEC does not make valid reappointments, its non-final prior decisions will likely be vacated and dismissed without prejudice. There will be no prejudice because the dismissals will not be adjudications on the merits.⁴⁶⁸ This would permit the SEC to re-try the cases, subject to any

er to adopt these exceptions. See *Bailey*, 557 U.S. at 154 n.6 (“This is no occasion to address whether we adopt all of these exceptions.”). FED. R. CIV. P. 60(b)(4) provides that the court may relieve a party from a final judgment, order, or proceeding if the judgment is void, but a jurisdictional error must be egregious in order for a final judgment to be treated as void. To be egregious, and thus void under Rule 60(b)(4), “the error must involve a clear usurpation of judicial power, where the court wrongfully extends its jurisdiction beyond the scope of its authority.” *United States v. Tittjung*, 235 F.3d 330, 335 (7th Cir. 2000).

463 Peter D. Hardy, Carolyn H. Kendall & Abraham J. Rein, *The Appointment of SEC Administrative Law Judges: Constitutional Questions and Consequences for Enforcement Actions*, 47 BLOOMBERG BNA SEC. REG. & L. REP 1238 (June 22, 2015). But see Peter J. Henning, *S.E.C. Finds Itself in a Constitutional Conundrum*, N.Y. TIMES: DEALBOOK (June 15, 2015), <http://nyti.ms/1MFZEVD> (suggesting possibility that penalties in every SEC AP that took place before an ALJ whose appointment was unconstitutional may be improper).

464 Stephanie Russell-Kraft, *SEC to Appeal District Judge’s Admin Court Injunction*, LAW360 (June 15, 2015, 6:21 PM), <http://www.law360.com/articles/667995/sec-to-appeal-district-judge-s-admin-court-injunction>.

465 *Ryder v. United States*, 515 U.S. 177 (1995).

466 *Id.* at 180–88.

467 See, e.g., *Nguyen v. United States*, 539 U.S. 69, 83 (2003) (vacating a Ninth Circuit decision by a three-judge panel that included an ineligible Article IV territorial judge).

468 See, e.g., *Havens v. Mabus*, 759 F.3d 91, 98 (D.C. Cir. 2014) (holding that a jurisdictional dismissal is not on the merits).

statute of limitations bar, in federal district court or before a properly-appointed ALJ.

The SEC can try to avoid invalidation of decisions rendered in administrative proceedings under one of two primary theories, but neither is likely to succeed. The SEC can argue either that application of the *de facto* officer doctrine precludes invalidation of decisions by its ALJs, or that such decisions are valid because they were ratified by the Commission.

The *de facto* officer doctrine confers validity upon acts performed by a person acting under the color of title even though it is later discovered that that person's appointment or election to office was invalid.⁴⁶⁹ The doctrine at first glance appears to be a perfect fit for SEC ALJs who were not properly appointed. But in *Ryder*, the Supreme Court rejected application of the doctrine to the improperly constituted Coast Guard Court of Military Review. According to the Supreme Court, application of the doctrine would create a disincentive to raise Appointments Clause challenges to questionable judicial appointments.⁴⁷⁰ The same may be true with regard to SEC ALJs.

Alternatively, the SEC could invoke the theory of ratification, under general principles of agency law. The Restatement (Third) of Agency specifies that "ratification is the affirmance of an act by one for or on behalf of another at a time when he had no authority to do the act for the one in whose name it was done."⁴⁷¹ As noted, SEC ALJs' decisions do not become final until the Commission approves them, either expressly or tacitly. The SEC could argue that the decisions by its ALJs, who are its agents, were ratified by the Commission. However, this argument is unlikely to prevail. If the argument could succeed, it "essentially would make the Appointments Clause a nullity for inferior officers, since there would be no need to follow the Clause's requirements so long as a principal officer was prepared to ratify the unconstitutionally-appointed officer's acts."⁴⁷²

469 *Ryder*, 515 U.S. at 180. See also Kathryn A. Clokey, Note, *The De Facto Officer Doctrine: The Case for Continued Application*, 85 COLUM. L. REV. 1121, 1126 (1985) (noting gradual erosion of the doctrine).

470 *Ryder*, 515 U.S. at 182–83. See also *United States v. Jones*, 74 M.J. 95, 96–97 (Armed Forces Crim. App. 2015) (rejecting the application of *de facto* officer doctrine to retired judge advocate colonel's participation in judgment of United States Air Force Court of Criminal Appeals). However, in *Buckley* the Court invoked the *de facto* officer doctrine to uphold the acts of an improperly constituted Federal Election Commission. *Buckley v. Valeo*, 424 U.S. 1, 142 (1976).

471 RESTATEMENT (THIRD) OF AGENCY § 4.02 cmt. b (Am. Law Inst. 2006).

472 See Hardy, Kendall & Rein, *supra* note 463.

Overall, the SEC is confronted with the prospect that many of the decisions by its ALJs could be vacated. How much of an administrative burden would this create for the SEC? In order to answer this question it may be helpful to look at some prior situations in which the appointments of members of an administrative agency were ruled invalid. In *New Process Steel, L.P. v. NLRB*,⁴⁷³ decided in 2010, the Supreme Court invalidated 595 decisions made by a two-member NLRB board. Most of these matters settled, and ultimately only 112 were re-decided. Disposing of all 112 cases took more than three years.⁴⁷⁴ The vast majority of the original decisions in these cases were affirmed.⁴⁷⁵

In *Noel Canning v. NLRB*,⁴⁷⁶ decided in 2014, the Supreme Court invalidated more than 700 reported and unreported decisions⁴⁷⁷ by an NLRB that included three members selected by invalid recess appointments. These 700 decisions included “a significant number of highly controversial decisions that either modified or overruled past Board precedent.”⁴⁷⁸ In addition, several NLRB regional directors whose appointments were approved by the improperly-constituted Board were confronted with possible collateral attacks on enforcement actions taken by them.⁴⁷⁹ Subsequently, the NLRB unanimously ratified *nunc pro tunc* the appointments of three of its regional directors and five of its ALJs,⁴⁸⁰ and those regional directors ratified all actions taken by them or on their behalf from the dates of their initial

473 560 U.S. 674, 674–75 (2010). The case is discussed in Julia Di Vito, Note, *The New Meaning of New Process Steel, L.P. v. NLRB*, 46 WAKE FOREST L. REV. 307, 330 (2011).

474 Abigail Caplovitz Field, *Possible Impacts of the Noel Canning Decision*, CORP. SECRETARY (Mar. 13, 2014), <http://www.corporatesecretary.com/articles/regulation-and-legal/12682/possible-impacts-noel-canning-decision/>.

475 Francis L. Van Dusen, Jr. & Wayne Landsverk, Employment Law Half-Day Seminar, *Lost in Space: The NLRB After Noel Canning*, MILLER NASH LLP (2014), <http://www.millernash.com/files/Event/76543c0f-49af-406b-bb54-bfd6bb0fd26f/Presentation/EventAttachment/b590f9d3-6320-4146-89b0-c0225f59fa1a/The%20NLRB%20After%20Noel%20Canning.pdf>.

476 *Noel Canning v. NLRB*, 134 U.S. 2550 (2014).

477 See Bryan J. Leitch, *NLRB v. Noel Canning: The Separation-of-Powers Dialogue Continues*, 2013–14 CATO SUPREME COURT REV. 221, 252–53 (“Between January 2012 and August 2013, the NLRB ‘recess’ appointments issued roughly 700 reported and unreported decisions while sitting on quorum-less boards.”).

478 G. Roger King & Bryan J. Leitch, *The Impact of the Supreme Court’s Noel Canning Decision—Years of Litigation Challenges on the Horizon for the NLRB*, BLOOMBERG BNA LAW (June 27, 2014), <http://www.bna.com/impact-supreme-courts-n17179891624>.

479 Leitch, *supra* note 477, at 253.

480 NLRB OFFICE OF PUBLIC AFFAIRS, NLRB OFFICIALS RATIFY AGENCY ACTIONS TAKEN DURING PERIOD WHEN SUPREME COURT HELD BOARD MEMBERS WERE NOT VALIDLY APPOINTED (Aug. 4, 2014), <https://www.nlr.gov/news-outreach/news-story/nlr-officials-ratify-agency-actions-taken-during-period-when-supreme-court>.

appointments.⁴⁸¹ The impact of these ratifications is unclear.⁴⁸² The NLRB ultimately identified approximately 100 decisions that required review⁴⁸³ after being invalidated by *Noel Canning*, and in 2015 the board was reported to be moving through this backlog of cases, “generally ‘rubber-stamping’ its prior opinions, even when controversial.”⁴⁸⁴

One final example is of interest. In 2008, Congress passed legislation which attempted to cure on a prospective basis the invalid appointments of administrative patent judges of the Board of Patent Appeals and Interferences (“BPAI”).⁴⁸⁵ The appointments were unconstitutional because they were made by the Director of the Patent and Trademark Office (“PTO”), who was not a head of a department.⁴⁸⁶ Instead, he was subordinate to the Secretary of Commerce.⁴⁸⁷ The legislation, signed by President George W. Bush, provides for appointments to be made by the Secretary.⁴⁸⁸ It also offers two alternative mechanisms to address the problem of prior decisions. First, the statute authorizes the Secretary of Commerce to make new appointments of existing administrative patent judges that take effect at the time when the Director of the PTO had previously purported to make the appointments.⁴⁸⁹ Professor John Duffy, who first discovered the BPAI appointment problem, has described the statute’s retroactive appointments as “unprecedented in constitutional history.”⁴⁹⁰ Second, the statute states that the *de facto* officer doctrine shall be a defense to a challenge to the appointment of an administrative patent judge on the basis that the judge was originally appointed by the PTO Director.⁴⁹¹ It is unclear what effect, if any, Congress’s alternative retroactive fixes had in this situation, because the issue has not been ful-

481 Seth Borden, *Does the National Labor Relations Board’s Recent Ratification Announcement Have Any Impact on Actions Invalidated by Noel Canning?*, LABOR RELATIONS TODAY (Aug. 6, 2014), <http://www.laborrelationstoday.com/2014/08/articles/uncategorized/does-the-national-labor-relations-boards-recent-ratification-announcement-have-any-impact-on-actions-invalidated-by-noel-canning/>.

482 *Id.*

483 Paul Kind, *Putting the Rabbit Back in the Hat: Noel Canning’s Impact on Eighteen Months of NLRB Decisions and Future Presidential Appointments*, 48 LOY. L.A. L. REV. 493, 502 (2015).

484 Christine Holst, *Ripples of Noel Canning Continue*, NAT’L L. REV. (Feb. 20, 2015), <http://www.natlawreview.com/article/ripples-noel-canning-continue>.

485 See Pub. L. No. 110-313, 122 Stat. 3014 (2008) (codified at 35 U.S.C. § 6 (2012)).

486 John F. Duffy, *Are Administrative Patent Judges Unconstitutional?*, 77 GEO. WASH. L. REV. 904, 910-11 (2009).

487 *Id.* at 911.

488 35 U.S.C. § 6(a) (2012).

489 35 U.S.C. § 6(c) (2012).

490 Duffy, *supra* note 486, at 920.

491 35 U.S.C. § 6(d) (2012).

ly litigated.⁴⁹² But insofar as the statute has not been deemed unconstitutional, it might serve as a model in some respects for a solution to the SEC's ALJ problem.

III. NORMATIVE ARGUMENTS

For the reasons set forth above, the bulk of the constitutional arguments advanced in opposition to use by the SEC and CFTC of administrative proceedings are defective. The sole exception is that the SEC's appointment of its ALJs may be unconstitutional. The SEC should revise its appointments process so that its ALJs are appointed by the Commission. But this is not the end of the debate, because there are strong normative arguments in favor of reforming the AP process.⁴⁹³ The next Part of this Article examines the normative debate.

A. *Impaired Development of Federal Securities Law*

An initial normative argument against the use of administrative enforcement is that such use impairs the development of federal securities laws, insofar as the cases are adjudicated by ALJs rather than federal district judges. Judge Rakoff has forcefully advanced this argument. He stated: “[T]he judiciary and the public should be concerned about any trend toward preferring the S.E.C.’s internal administrative forum to the federal courts [because] it hinders the balanced development of the securities laws.”⁴⁹⁴ Rakoff has noted that most of the significant SEC enforcement actions are brought under Section 10(b) of the Exchange Act⁴⁹⁵ and Section 17(a) of the Securities Act of 1933 (“Securities Act”),⁴⁹⁶ and the development of the law under these provisions has been mostly judge-made.⁴⁹⁷

Judge Rakoff provided the example of insider trading: “[A]lmost all the major advances in the development of the law of insider trad-

⁴⁹² See, e.g., *In re DBC*, 545 F.3d 1373, 1381 (Fed. Cir. 2008) (“[W]e take no position on the constitutionality of the [de facto officer] defense.”); *Stryker Spine v. Biederman Motech GmbH*, 684 F. Supp. 2d 68, 84 (D.D.C. 2010) (noting issue but not deciding it).

⁴⁹³ See Cox, *supra* note 24, at 2 (“The most interesting and practical questions about APs are not constitutional in nature, however, but normative.”).

⁴⁹⁴ Rakoff, *supra* note 16, at 7. Others share Judge Rakoff’s concern. See, e.g., William F. Johnson, *Is it Time to Reconsider “Chevron” Deference for SEC Proceedings?*, N.Y. L.J., July 2, 2015, at 1 (“[O]ne consequence of bringing more administrative cases is that the SEC can have a greater influence than federal judges in interpreting the securities laws.”).

⁴⁹⁵ Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012).

⁴⁹⁶ Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (2012).

⁴⁹⁷ Rakoff, *supra* note 16, at 8.

ing . . . have occurred in federal courts, usually either the Supreme Court or the Second Circuit.”⁴⁹⁸ Judge Rakoff’s concern is that as administrative creep continues at the SEC, federal courts will have fewer and fewer opportunities to shape the law of insider trading and other aspects of federal securities law. He noted that while federal courts review decisions of SEC ALJs, those decisions on otherwise undecided issues of statutory interpretation are entitled to *Chevron* deference and thus are unlikely to be reversed.⁴⁹⁹ According to Judge Rakoff, this is unfair in the short-run to litigants who are given less balanced, careful, and impartial decisions than they would receive in federal court, and it is unfair in the long-run to the SEC, whose reputation for impartiality will continue to decline.⁵⁰⁰

Judge Rakoff’s argument is compelling, but it has some flaws. First, the argument ignores the countervailing benefit of administrative adjudication by agency ALJs who develop an expertise in the federal securities laws and subsequent *de novo* review by SEC and CFTC commissioners who are widely regarded as subject matter experts.⁵⁰¹

Second, Judge Rakoff’s selection of insider trading to illustrate his argument is questionable, in a couple of respects. To begin, SEC APs have made a major positive contribution to the development of insider trading law. As Professor Donald Langevoort has noted, “a sizable number of well-known insider trading cases . . . have arisen through administrative proceedings.”⁵⁰² These include the seminal cases of

498 *Id.*

499 *Id.* at 10–11.

500 *Id.* at 11. Cf. Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAWYER 1, 44 (2015–16) (“APs hinder balanced development of the securities laws not because of *Chevron* deference, but because they too often keep respondents out of the process, thereby depriving adjudicators of input from the regulated industry.”).

501 See, e.g., *Ceresney Remarks*, *supra* note 19, at 5 (noting that the SEC’s expanded use of APs “furthers the balanced and informed development of the federal securities laws,” because “SEC commissioners have great expertise” in this field). But see *Elliott v. CFTC*, 202 F.3d 926, 940 (7th Cir. 2000) (Easterbrook, J., dissenting) (“Ever since Congress began to establish independent agencies in 1887, it has been customary to refer to a commission’s ‘expertise.’ This is a figure of speech, an honorific, rather than a description of commissioners’ backgrounds and skills. It would be more accurate to call commissioners of the CFTC (and other agencies) ‘specialists.’”). In this case, only one of the four commissioners who participated in the order under review had any trading experience, and he dissented. *Id.*

502 18 DONALD C. LANGEVOORT, *INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION* § 8:17 (2012). See also Stephanie Russell-Kraft, *Ceresney Rebuts Rakoff’s Critique of SEC Admin. Actions*, LAW 360 (Nov. 7, 2014, 3:30 PM ET), <http://www.law360.com/articles/594489/ceresney-rebuts-rakoff-s-critique-of-sec-admin-actions> (citing SEC Enforcement Director for proposition that SEC’s ALJs have contributed their expertise to develop various areas of securities law, “including the prosecution of insider trading”).

*Dirks v. SEC*⁵⁰³ and *In re Cady, Roberts & Co.*⁵⁰⁴ Indeed, *Cady*, decided more than fifty years ago, was the first insider trading decision ever issued under the federal securities laws and the “vast majority” of insider trading cases decided in the decades since then have adhered to its basic analysis.⁵⁰⁵

In any event, it is certainly debatable whether the post-*Cady* judicial development of federal insider trading law has been a net positive. A recent analysis of the law began with this observation: “Federal insider trading law seems to be a ‘theoretical mess.’ According to the consensus view among experts, it is ‘seriously flawed,’ ‘ill-defined,’ ‘inconsistent,’ ‘astonishingly dysfunctional,’ ‘enigma[ti]c,’ and even ‘an ass.’”⁵⁰⁶ The generally poor performance by federal courts in developing insider trading law undermines the argument that administrative creep at the SEC is disadvantageous because it impedes the development of such law by Article III judges.

Third, the extent to which the SEC and CFTC should or do obtain *Chevron* deference from the federal circuit courts with regard to interpretations presented in the course of adjudications—as opposed to rulemaking—is a matter of some dispute. The Second Circuit has noted that *Chevron* deference typically has not been afforded where “the agency’s interpretation is presented in the course of litigation and has not been ‘articulated before in a rule or regulation.’”⁵⁰⁷ Moreover, it is doubtful whether issues addressed in dicta in agency decisions that were not briefed by the parties are entitled to *Chevron* deference. This situation arose in *In the Matter of John P. Flannery & James D. Hopkins*,⁵⁰⁸ decided by the Commission in 2014 and subsequently appealed to the First Circuit. In *Flannery* the Commission—in a 3-2 decision effectively reversing the decision of the ALJ—made

503 463 U.S. 646 (1983).

504 Exchange Act Release No. 6668, 40 S.E.C. 907 (1961).

505 Crimmins, *supra* note 35, at 332.

506 Sung Hui Kim, *Insider Trading as Private Corruption*, 61 UCLA L. REV. 928, 931 (2014) (citations omitted).

507 *SEC v. Rosenthal*, 650 F.3d 156, 160 (2d Cir. 2011) (citation omitted); *see also* *Chau v. SEC*, 72 F. Supp. 3d 417, 436 (S.D.N.Y. 2014) (noting that the Second Circuit has not definitively stated whether SEC interpretations made during adjudicatory proceedings are entitled to deference), *aff’d*, No. 15-461, 2016 WL 7036830 (2d Cir. Dec. 2, 2016); Bradley George Hubbard, Comment, *Deference to Agency Statutory Interpretations First Advanced in Litigation? The Chevron Two-Step and the Skidmore Shuffle*, 80 U. CHI. L. REV. 447, 448 (2013) (noting that five federal circuits deny deference to agency statutory interpretations first advanced during litigation).

508 Securities Act Release No. 9689, Exchange Act No. 73840, Investment Company Act Release No. 31374, 2014 WL 7145625 (Dec. 15, 2014), *vacated sub nom.* *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2015).

an “overt bid for *Chevron* deference”⁵⁰⁹ by offering a fifteen-page commentary on the proper interpretation of Section 10(b) of the Exchange Act, companion Rule 10b-5,⁵¹⁰ and Section 17(a) of the Securities Act in the wake of the Supreme Court’s decision in *Janus Capital Group, Inc. v. First Derivative Traders*.⁵¹¹ *Janus* held that a person is liable under Section 10(b) and Rule 10b-5 for making a false or misleading statement only if he had “ultimate authority” for that statement.⁵¹² *Janus* left numerous unanswered questions, and the Commission, in *Flannery*, attempted to answer many of them, even as to issues not briefed by the parties. On appeal, the First Circuit vacated the Commission’s Order in 2015,⁵¹³ although it did not address the Commission’s *Janus* interpretation. A recent review expressed doubt that the CFTC “will continue to be afforded *Chevron* deference in cases involving aggressive interpretations or applications of [Dodd-Frank] made in the course of agency adjudications.”⁵¹⁴ The same doubt may apply to the SEC and the Exchange and Securities Acts.⁵¹⁵

Fourth, and more broadly, the extent to which *Chevron* has any impact on the judiciary has been widely debated. Many scholars have concluded that *Chevron*, the most-cited decision in administrative law,⁵¹⁶ has had no substantial effect. One recent review noted: “[E]mpiricists have had difficulty determining whether *Chevron* has actually had an impact in the real world.”⁵¹⁷ To the extent that *Chevron* deference is a principle more often honored in the breach than the observance, once again Judge Rakoff’s concern seems unwarranted.

509 Andrew Vollmer, *The SEC’s Expansion of Primary Liability Under Section 17(a) and Rule 10b-5*, CLS BLUE SKY BLOG (Sept. 9, 2015), <http://clsbluesky.law.columbia.edu/2015/09/09/the-secs-expansion-of-primary-liability-under-section-17a-and-rule-10b-5/>.

510 17 C.F.R. § 240.10b-5 (2015).

511 131 S. Ct. 2296 (2011).

512 *Janus*, 131 S. Ct. at 2302.

513 *Flannery v. SEC*, 810 F.3d 1, 15 (1st Cir. 2015).

514 Berkovitz, *supra* note 85, at 10.

515 See Matthew Martens et al., “We Intend to Resolve the Ambiguities”: *The SEC Issues Some Surprising Guidance on Fraud Liability in the Wake of Janus*, 47 SEC. REG. & L. REP. (BNA) 220, 220 n.12 (Feb. 2, 2015) (expressing skepticism that *Flannery*’s dicta, issued in the absence of briefing by the parties, “is the type of ‘formal adjudication’ the *Chevron* Court intended would be afforded deference from the courts”).

516 Michael Herz, Essay, *Chevron is Dead; Long Live Chevron*, 115 COLUM. L. REV. 1867, 1870 n.19 (2015).

517 *Id.* at 1878; see also Connor N. Raso & William N. Eskridge, Jr., *Chevron as a Canon, Not a Precedent: An Empirical Study of What Motivates Justices in Agency Deference Cases*, 110 COLUM. L. REV. 1727, 1817 (2010) (“Academics and practitioners alike frequently assume that federal judges faithfully defer to agency interpretations of statutes. This untested assumption has underpinned much of the debate over the scope and extent of deference doctrine. Our analysis finds that this assumption is unfounded.”).

Finally, Justice Clarence Thomas and the late Justice Antonin Scalia recently suggested, in an opinion denying a petition for a writ of *certiorari*, that agency interpretations of laws that are subject to both criminal and administrative enforcement are not entitled to deference.⁵¹⁸ Their suggestion, if ultimately accepted by the Court, would encompass interpretations by the SEC of the laws it administers, because most of those laws can give rise to either civil or criminal liability.⁵¹⁹ Given that Justices Scalia and Thomas have “led major shifts in criminal law jurisprudence”⁵²⁰ during the past decade, the Court’s eventual acceptance of the position staked out by them is not far-fetched.

Overall, to the extent that courts decline to grant deference to statutory interpretations made during the course of SEC and CFTC adjudications, concerns about impaired development of the federal securities laws should dissipate. On the other hand, if the SEC loses *Chevron* deference, it simultaneously will lose a key advantage of its plan to pursue enforcement in-house. Recall that the fourth factor of the Division guidance issued in May 2015 concerning choice of venue—which refers to the Commission’s “expertise” in securities matters—is a clear allusion to the SEC’s expectation that its rulings interpreting the federal securities laws are entitled to *Chevron* deference. That expectation would be dashed if the late Justice Scalia’s views about laws subject to both criminal and administrative enforcement ultimately prevail.⁵²¹

518 *Whitman v. United States*, 135 S. Ct. 352 (2014).

519 Joseph Boryshansky et al., *SEC’s Authority to Interpret the Securities Laws Comes Under Fire in Criminal Enforcement*, 16 J. INVESTMENT COMPLIANCE 41, 42 (2015), <https://www.akingump.com/images/content/3/7/v2/37892/110887713-1.pdf> (“Since many of the laws the SEC enforces can give rise to criminal sanctions, the SEC could be denied deference in a wide range of cases, leaving its rules subject to frequent challenge.”).

520 SULLIVAN & CROMWELL LLP, *Whitman v. United States: U.S. Supreme Court Considers Deference to Agencies’ Interpretations of Criminal Statutes*, 3 (Nov. 13, 2014), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Whitman_v_United_States_US_Supreme_Court_Considers_Deference_to_Agencies_Interpretations_of_Criminal_Statutes.pdf.

521 See Matthew T. Martens et al., *Scalia’s Deference Argument Could Have Dramatic Effects*, LAW360 (Nov. 18, 2014, 11:57 AM), http://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/Scalias-Deference-Argument-Could-Have-Dramatic-Effects-Law360.pdf (“[W]ere Justice Scalia’s position to become the law, it would eliminate one of the major tactical advantages for the SEC when it brings an enforcement action in an administrative proceeding, rather than in district court.”).

B. Perception of Unfairness and Absence of Independence

A second normative argument is that the SEC's administrative process is unfair or creates a perception of unfairness, even if it does not result in a statutory violation or a denial of due process or equal protection. Closely related is the argument that SEC ALJs lack the requisite degree of independence. Allegations of bias in APs are common, but federal courts have consistently rejected such allegations by respondents in CFTC APs.⁵²² Other observers have had differing opinions. More than twenty years ago an American Bar Association Task Force ("ABA Task Force") concluded that the combination of prosecutorial and adjudicative functions in the SEC "adversely affects in a fundamental way the perceived and actual fairness of the process"⁵²³ This concern may be even more salient today, in light of the SEC's greatly expanded use of APs. But the criticism is not universal. For example, the ACUS examined the amalgamation of functions of federal agencies and concluded that the model "appears, on the whole, to have worked satisfactorily in providing fair and impartial factfinding"⁵²⁴

An examination of the fairness argument requires an understanding of the ALJ selection process. The SEC currently employs five ALJs. As noted, most or all of them were hired by the SEC's Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, and the OPM. Each of the current ALJs served as a law judge at another agency before transferring to the SEC staff. None of the current SEC ALJs were part of the SEC staff in any capacity or had practiced securities law extensively prior to becoming an ALJ.⁵²⁵ This situation differs from historical practice. During the period 1964–1994 a majority of the SEC's ALJs were members of the agency's staff prior to becoming ALJs.⁵²⁶ Prior service produced the benefits of expertise concerning both federal securities laws and the securities industry. But prior service came at a potential cost, which was bias in favor of the SEC.

522 See JERRY W. MARKHAM, 13A COMMODITIES REG. § 20:32, Westlaw (database updated Apr. 2016) (collecting cases).

523 *Task Force Report*, *supra* note 111, at 1733.

524 ADMIN. CONFERENCE OF THE U.S., RECOMMENDATION 86-4: THE SPLIT-ENF'T MODEL FOR AGENCY ADJUDICATION 1, (Dec. 4, 1986) <https://www.acus.gov/recommendation/split-enforcement-model-agency-adjudication>.

525 DORFMAN & WINER, *supra* note 22, at § 19.04(1); U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 17 ("During the past 30 years, the SEC has not hired a single ALJ who had directly relevant experience or expertise related to the federal securities laws.")

526 DORFMAN & WINER, *supra* note 22, at § 19.04(1).

What has the elimination of prior service accomplished? One obvious effect is that the ALJs' collective expertise has been significantly reduced, at least with respect to new judges. Two of the five ALJs employed by the SEC in 2016 began service in 2014, and whatever securities expertise they now have has been acquired only since then. But this does not necessarily mean the SEC ALJs' overall competence is less than it was when they always had prior staff service. Prominent defense counsel acknowledge that they "have no reason to believe these [current SEC] ALJs are anything other than capable, fair, and evenhanded jurists."⁵²⁷ Moreover, the elimination of prior service and the commensurate reduction in expertise may merely mean that respondents' counsel have been placed on a more even playing field with SEC staff in their interactions with SEC ALJs.⁵²⁸

Has the reduction of prior service solved the problem of actual or perceived bias? One SEC ALJ, in office from 1995–2007, alleged that she was pressured by Chief ALJ Brenda Murray to find more often in favor of the SEC.⁵²⁹ In June 2015 the SEC's Office of Inspector General ("OIG") launched an investigation at the request of SEC Chair Mary Jo White concerning claims that SEC ALJs are biased.⁵³⁰ The OIG issued an Interim Report of Investigation in August 2015 which advised that the Inspector General "has not developed any evidence to support the allegations of bias in ALJs' decisions in the Commission's administrative proceedings."⁵³¹ The OIG issued a final Report of Investigation in January 2016 which confirmed the interim findings. The Report noted, *inter alia*, that the OIG did not develop any evidence to support the allegations of improper influence or the al-

527 Davison et al., *supra* note 20, at 106–07; *see also* U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 58 n.60 ("[A]ttorneys in private practice uniformly praise[] the expertise, experience, professionalism, and integrity of the two [SEC] ALJs who have served for an extended period of time . . .").

528 *See* DORFMAN & WINER, *supra* note 22, at § 19.04(1) (noting the more level playing field).

529 Eaglesham, *supra* note 11 (discussing allegations of pressure by Chief Judge Murray).

530 Ed Beeson, *SEC Inspector General Probes in-House Judge Bias Charges*, LAW360 (Aug. 10, 2015, 1:02 PM), <http://www.law360.com/articles/689115/sec-inspector-general-probes-in-house-judge-bias-charges>.

531 SEC OFFICE OF INSPECTOR GEN., INTERIM REPORT OF INVESTIGATION, Case #15-ALJ-0482-1, at 4 (Aug. 5, 2015), <http://www.sec.gov/oig/reportspubs/oig-sec-interim-report-investigation-admin-law-judges.pdf>. *See also* William McLucas & Matthew Martens, *How to Rein in the SEC*, WALL ST. J. (June 2, 2015, 6:55 PM), <http://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747> ("Whatever the complaints about the administrative process, there is no evidence that the ALJs harbor bias."); Cox, *supra* note 24, at 6 (concluding that SEC ALJs "unfailingly strive to be independent"); Walfish, *supra* note 10 (noting that SEC ALJs "strive to be fair to all parties").

legation that SEC ALJs were pressured to shift the burden of proof to respondents.⁵³²

Even in the absence of actual bias the perception problem remains, and it extends to appeals. Recall that the Commissioners authorize all enforcement actions and subsequently act as the first level of appeal. The Commission's decision to proceed with an enforcement action reflects a substantive judgment about the strength and merit of a case. If the Commissioners ultimately side with the Division on appeal, they may "not have done so with the disinterestedness required for credibility and legitimacy."⁵³³ Many respondents in SEC APs believe they do not receive fair hearings or appeals,⁵³⁴ and that this unfairness manifests in the SEC's record of home court success. Indeed, the Commissioners almost never dismiss a case after they have authorized issuance of an OIP.⁵³⁵ In this context the perception of bias or unfairness may be almost as important as the presence of bias.⁵³⁶ And the perception is magnified by the adverse SEC and CFTC procedures described above.

IV. PROPOSED SOLUTIONS

A number of solutions to the problems identified above have been proposed. The next part of this Article considers the merits and disadvantages of some of the most common proposals.

A. *Establishment of a Federal ALJ Corps*

One proposal is that the federal government should establish and utilize for agency adjudication a corps of independent ALJs who are

⁵³² SEC OFFICE OF INSPECTOR GEN., REPORT OF INVESTIGATION, Case #15-ALJ-0482-1, at 21–22 (Jan. 21, 2016), <https://www.sec.gov/oig/reportspubs/Final-Report-of-Investigation.pdf>.

⁵³³ Walfish, *supra* note 10.

⁵³⁴ *See, e.g.,* Cox, *supra* note 24 ("At a minimum, it *appears* to [respondents] and to the outside world that the process is much less fair.").

⁵³⁵ David Zornow, Comment Letter on Proposed Amendments to the Commission's Rules of Practice (Dec. 2, 2015), <https://www.sec.gov/comments/s7-18-15/s71815-6.pdf> ("[I]f it has ever occurred, it is extremely rare for a Commissioner to dismiss a case after having already been persuaded to approve the very institution of those proceedings.>").

⁵³⁶ *See, e.g.,* Task Force Report, *supra* note 111, at 1734 ("Even if the inference of bias from the number of cases decided for the [SEC] Staff is not warranted in fact, the public perception to this effect may be every bit as damaging to the public confidence in the integrity and fairness of the process."); Henning, *supra* note 213 ("[T]his battle is more about the perception that the administrative process is flawed, not whether there is actually a significant home court advantage."); Olson, *supra* note 129 ("The perception that administrative proceedings are fundamentally unfair has damaged the credibility of the SEC's enforcement system.").

not employees of any specific agency. Such a corps has been widely used at the state level—and to a much lesser extent at the local level⁵³⁷—in the form of central panels. Central panels vary greatly in their organization,⁵³⁸ but in general a panel is an agency of ALJs established to conduct administrative adjudications for other agencies.⁵³⁹ These ALJs are independent of, and not subject to control or influence by, the agencies for which they conduct administrative hearings. Instead, the ALJs report to a chief ALJ or central panel director.⁵⁴⁰

Central panels have existed since the 1940s. A Model Act for their adoption has been drafted,⁵⁴¹ at least twenty-seven states and three major cities have established such panels,⁵⁴² and at least eleven states have adopted them since 1990.⁵⁴³ No state that has adopted a central panel has returned to decentralization.⁵⁴⁴ The adoption of central panels has been described as the most significant development in U.S. administrative law⁵⁴⁵ and a substantial body of research and commentary on many aspects of this development has been published. Central ALJ panels offer several advantages, including an enhanced perception of fairness,⁵⁴⁶ improved efficiency,⁵⁴⁷ and lower costs.⁵⁴⁸

537 Allen C. Hoberg, *Ten Years Later: The Progress of State Central Panels*, 21 J. NAT'L ASS'N ADMIN. LAW JUDICIARY 235, 246 (2001) ("The central panel system is slowly gaining popularity amongst large cities too.").

538 See Moliterno, *supra* note 162, at 1230.

539 Barnett, *supra* note 18, at 828 ("Perhaps the most popular remedial proposal is for a unified ALJ corps (sometimes referred to as an ALJ central panel) appointed and supervised by an existing or newly created independent agency.").

540 Larry J. Craddock, *Final Decision Authority and the Central Panel ALJ*, 33 J. NAT'L ASS'N ADMIN. L. JUDICIARY 471, 477 (2013).

541 See House of Delegates of American Bar Ass'n, *Model Act Creating a State Central Hearing Agency*, 17 J. NAT'L ASS'N ADMIN. LAW JUDICIARY 313 (1997) (reprinting the Model Act).

542 John Hardwicke & Thomas E. Ewing, *The Central Panel: A Response to Critics*, 24 J. NAT'L ASS'N ADMIN. LAW JUDGES 231 (2004).

543 James F. Flanagan, *An Update on Developments in Central Panels and ALJ Final Order Authority*, 38 IND. L. REV. 401, 402–04, 403 nn.13–14 (2005) (listing states and municipalities which have adopted central panels).

544 *Id.* at 404–05 (noting that no state had decentralized at least up until 2005).

545 Michael Asimow, *The Fourth Reform: Introduction to the Administrative Law Symposium on State Administrative Law*, 53 ADMIN. L. REV. 395, 396–99 (2001).

546 See, e.g., Michael Asimow, *The Administrative Judiciary: ALJs in Historical Perspective*, 20 J. NAT'L ASS'N ADMIN. LAW JUDICIARY 157, 164 (2000) ("Central panels have some very important advantages, particularly in giving private parties the sense their cases are being heard by an independent judge."); Ryan Jones, Comment, *The Fight Over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 536 (2015) ("[T]he SEC could remove a perception of in-house bias . . . by using independent ALJs who work from outside of the agency.").

547 See, e.g., Moliterno, *supra* note 162, at 1228 ("There is, in fact, significant evidence in support of the proposal of many administrative judges that a central panel would increase

Is the central panel model suitable for the federal government? Congress considered but rejected central panels when the APA was drafted in the 1940s⁵⁴⁹ and an ALJ corps option was proposed repeatedly in Congress between 1983 and 1995.⁵⁵⁰ The ACUS examined the issue during this latter period and recommended against a centralized approach at the federal level.⁵⁵¹ The published recommendation of the ACUS did not explain its rationale, but there are clear potential disadvantages to establishing and operating a federal central ALJ panel.

Perhaps the major potential disadvantage to operation of a federal central panel—and its use as a source of ALJs for SEC and CFTC administrative proceedings—is the loss of agency expertise that the current decentralized approach provides.⁵⁵² As noted, none of the current SEC ALJs have prior SEC staff experience and two of them have served at the SEC only since 2014.⁵⁵³ In addition, the CFTC has no ALJs of its own, and it is likely to borrow from other agencies when it resumes contested administrative enforcement. Nevertheless, SEC ALJs develop substantial securities law and industry expertise as their tenure continues at the agency,⁵⁵⁴ and this expertise is likely to be transferable to CFTC cases. The acquired expertise might be lost if

the efficiency of administrative adjudication as well as the impartiality of administrative adjudicators.”).

548 Hardwicke & Ewing, *supra* note 542, at 233 (“Experience has shown that a central panel is inherently more cost-effective than separate, independent hearing units.”).

549 Moliterno, *supra* note 162, at 1227.

550 U.S. GOV’T ACCOUNTABILITY OFF., GAO-10-14, RESULTS-ORIENTED CULTURES: OFFICE OF PERS. MGMT. SHOULD REVIEW ADMIN. LAW JUDGE PROGRAM TO IMPROVE HIRING AND PERFORMANCE MGMT. 22 (2010), <http://www.gao.gov/products/GAO-10-14>. One bill passed the Senate in 1993 but never came to a vote in the House of Representatives. *Id.* at 23.

551 Moliterno, *supra* note 162, at 1228. *See also* Paul R. Verkuil et al., ADMIN. CONFERENCE OF THE U.S., RECOMMENDATION 92-7: THE FED. ADMIN. JUDICIARY (Dec. 10, 1992), <https://www.acus.gov/recommendation/federal-administrative-judiciary> (“Congress should not at this time make structural changes more extensive than those proposed here, such as those in recent legislative proposals to establish a centralized corps of ALJs.”).

552 *See, e.g.*, Barnett, *supra* note 18, at 829 n.20 (“[A] common criticism of the ALJ corps is that agencies lose the efficiency and specialized knowledge that exists when ALJs are housed within individual agencies.”).

553 The five ALJs employed by the SEC in 2016 were Brenda Murray, Carol Foelak, Cameron Elliott, James Grimes, and Jason Patil. Murray has served as an SEC ALJ since 1988, Foelak since 1996, Elliott since 2011, Grimes since June 2014, and Patil since September 2014. Murray has served as the Chief ALJ since 1994. *See* Davison et al., *supra* note 20, at 106–07 n.29 (listing the five SEC ALJs and their experience at the SEC).

554 *See, e.g.*, Ceresney Remarks, *supra* note 19 (“[SEC] ALJs are focused on hearing and deciding securities cases, year after year. They develop expert knowledge of the securities laws, and the types of entities, instruments and practices that frequently appear in our cases.”).

SEC and CFTC administrative proceedings were to be staffed by ALJs sourced from a central panel at the federal level.

The foregoing argument concerning loss of expertise has been rebutted—at least with regard to state central panels—by state ALJs and other observers. The rebuttal notes the following: (1) the chief ALJs in states using central panels endeavor to make ALJ assignments based on the expertise of particular judges, (2) in many cases subject matter expertise is non-essential, and (3) empirical evidence from some states where central panel ALJs have no authority to make final decisions without agency review shows that the decisions by ALJs are overwhelmingly affirmed on review, which suggests that the theorized crippling loss of expertise is a false assumption.⁵⁵⁵

The foregoing rebuttal may be valid with regard to central panels at the state level. But it is not at all clear that the rebuttal retains its validity with regard to a federal central panel. Cases at the federal level are likely to be more complex⁵⁵⁶—perhaps considerably more so—and this increased complexity may very well render a federal central panel unfeasible. In any event, as noted by Professor Barnett, “Given the ACUS’s lack of support for an ALJ corps and the proposal’s failure to gain political traction after more than sixty years, the proposal to create a federal ALJ corps appears moribund.”⁵⁵⁷

B. Adoption of the NLRB Model or a Split-Enforcement Model

The ABA Task Force recommended more than twenty years ago that the SEC’s authority to initiate an administrative enforcement proceeding be vested in an independent General Counsel’s office, in conformity with the long-standing practice at the NLRB.⁵⁵⁸ This recommendation was recently revived.⁵⁵⁹

The NLRB’s current enforcement structure has been in place since 1947. That year Congress passed the Taft-Hartley Act,⁵⁶⁰ which amended the NLRA and, among other things, restructured the NLRB by creating the office of the General Counsel. Before Taft-Hartley,

⁵⁵⁵ Hardwicke & Ewing, *supra* note 542, at 23–39.

⁵⁵⁶ See, e.g., *Ceresney Remarks*, *supra* note 19 (noting that many cases decided by SEC ALJs involve complex and novel legal issues); Stephanie Russell-Kraft, *CFTC Whistleblower Head Forecasts Big Things to Come*, LAW360 (May 1, 2015, 2:35 PM), <http://www.law360.com/articles/649672/cftc-whistleblower-head-forecasts-big-things-to-come> (noting highly technical nature of cases brought by CFTC).

⁵⁵⁷ Barnett, *supra* note 18, at 830.

⁵⁵⁸ *Task Force Report*, *supra* note 111, at 1737.

⁵⁵⁹ See, e.g., Walfish, *supra* note 10 (recommending adoption by SEC of NLRB enforcement model).

⁵⁶⁰ Pub. L. No. 80-101, 61 Stat. 136 (1947) (codified as amended at 29 U.S.C. §§ 151-166).

the NLRB simultaneously occupied the roles of investigator, prosecutor, jury, and judge.⁵⁶¹ This amalgamation of functions was widely criticized on the basis that it was unfair to defendants.⁵⁶² Since Taft-Hartley the NLRB's functions have been split, with the General Counsel acting independently of the NLRB, but in its name and on its behalf, in the pre-filing investigation, issuance, and prosecution of unfair labor practice complaints.⁵⁶³ The five members of the NLRB retain only adjudicative and policy-making functions.⁵⁶⁴ This bifurcated structure reflects the intent of Congress to differentiate between the final authority of the General Counsel and the NLRB along a prosecutorial versus adjudicative line.⁵⁶⁵

A similar but non-identical model is the split function or split-enforcement model, wherein Congress splits a major area of regulatory activity between two separate and independent agencies, granting rulemaking and prosecutorial authority to one of them and adjudicatory authority to the other.⁵⁶⁶

One example of this model is the OSH Act, which splits enforcement by assigning responsibility for setting and enforcing health and safety standards to the Occupational Safety and Health Administration and responsibility for adjudicating alleged violations of those standards to the OSHRC.⁵⁶⁷ The OSHRC employed twelve ALJs in 2016⁵⁶⁸ and they decide cases at the trial level. The three-member OSHRC, appointed by the President, provides administrative appellate review on a discretionary basis.⁵⁶⁹

561 *Int'l Ladies' Garment Workers Union, Local 415-75, AFL-CIO v. NLRB*, 501 F.2d 823, 828, 828 n.18 (D.C. Cir. 1974).

562 *Id.* at 828.

563 *Id.*

564 *See Innovative Commc'ns Corp. v. NLRB*, 39 F. App'x 715, 719 n.7 (3d Cir. 2002) (“[T]here is a clear division between the [NLRB’s] adjudicative functions and the General Counsel’s prosecutorial functions”); Francis M. Dougherty et al., 22 *FED. PROC.*, L. ED. § 52:251 (database updated Mar. 2015) (“The General Counsel . . . functions in investigative and prosecutory roles, and in so doing acts as an independent unit, with the NLRB itself retaining only its adjudicative and policymaking functions.”).

565 *NLRB v. United Food & Commercial Workers Union, Local 23*, 484 U.S. 112, 124 (1987); *NLRB v. Federal Labor Relations Auth.*, 613 F.3d 275, 278 (D.C. Cir. 2010).

566 32 CHARLES ALAN WRIGHT & CHARLES H. KOCH, JR., *FEDERAL PRACTICE & PROCEDURE JUDICIAL REVIEW* § 8217 (1st ed. database updated Apr. 2015).

567 George Robert Johnson, Jr., *The Split-Enforcement Model: Some Conclusions from the OSHA and MSHA Experiences*, 39 *ADMIN. L. REV.* 315, 315 (1987); Amanda Shami, Note, *Three Steps Forward: Shared Regulatory Space, Deference, and the Role of the Court*, 83 *FORDHAM L. REV.* 1577, 1594 (2014).

568 OCCUPATIONAL SAFETY & HEALTH REVIEW COMM'N, *Administrative Law Judges*, http://www.oshrc.gov/about/ALJ_bios.html (last visited Sept. 5, 2016).

569 OCCUPATIONAL SAFETY AND HEALTH REVIEW COMM'N, *Fiscal Year 2017 Performance Budget and Justification* 1 (Feb. 2016) (noting trial function of ALJs, as well as Presidential ap-

A second example of split-enforcement at the federal level is the Federal Mine Safety and Health Act of 1977 (“Mine Act”),⁵⁷⁰ which amended prior statutes concerning coal, metal, and non-metal mine safety and health and is modeled closely on the OSH Act’s administrative structure.⁵⁷¹ The Mine Act requires the Secretary of Labor to develop, promulgate, and enforce safety and health standards for the nation’s mining industry through the Mine Safety and Health Administration (“MSHA”)⁵⁷² and assigns the adjudication of contested enforcement actions to the independent Federal Mine Safety and Health Review Commission (“FMSHRC”).⁵⁷³ The FMSHRC employed fifteen ALJs in 2016⁵⁷⁴ and they decide cases at the trial level. The five-member FMSHRC provides administrative appellate review.⁵⁷⁵

The administrative structure of both the OSH Act and the Mine Act is similar to the NLRA’s, insofar as all three reflect an internal separation of function beyond what the APA mandates. Recall that while the APA prohibits agency staff from combining prosecutorial and adjudicative functions in the same case, it expressly exempts both the agency and agency members from this prohibited combination. The NLRA, OSH Act, and Mine Act administrative models all exceed the APA parameters. But the NLRA model differs from the other two. Whereas the General Counsel’s role at the NLRB is limited by Taft-Hartley to the investigation and prosecution of cases, Congress assigned to the Occupational Safety and Health Administration broad policy-making authority, which is implemented through the promulgation of occupational health and safety standards and the making of prosecutorial decisions.⁵⁷⁶ The Mine Act is similar to the OSH Act in this regard.

pointment of, and discretionary review by, OSHRC Commissioners), http://www.oshrc.gov/budget/fy17_budget.pdf.

570 Pub. L. No. 95-164, 91 Stat. 1290 (1977) (codified as amended at 30 U.S.C. §§ 801-961 (2012)).

571 Benjamin W. Mintz, *Administrative Separation of Functions: OSHA and the NLRB*, 47 CATH. U. L. REV. 877, 886 (1998).

572 Johnson, *supra* note 567, at 316.

573 Patrick R. Baker, *Stuck Between a Lump of Coal and a Hard Place: The Mine Safety and Health Administration’s Struggle with Due Process and America’s Coal Industry*, 117 W. VA. L. REV. 625, 626, 633 (2014) (noting that the Mine Act’s split-enforcement model was “designed to prevent regulatory capture”); Johnson, *supra* note 567, at 316.

574 FED. MINE SAFETY AND HEALTH REVIEW COMM’N, *Administrative Law Judges*, <https://www.fmshrc.gov/about/aljs> (last visited Aug. 1, 2016).

575 FED. MINE SAFETY AND HEALTH REVIEW COMM’N, JUSTIFICATION OF APPROPRIATION ESTIMATES FOR CONG. APPROPRIATIONS: FISCAL YEAR 2016, 1 (Feb. 2, 2015), <https://www.fmshrc.gov/plans/FMSHRC%20FY2016%20CBJ.pdf>.

576 Mintz, *supra* note 571, at 886–87.

Are the NLRB or split-enforcement models more equitable than the enforcement models used by the SEC and CFTC? The ACUS examined the split-enforcement model of the OSH Act and the Mine Act but was “unable to conclude whether this model achieves greater fairness in adjudication than does the traditional structural model.”⁵⁷⁷ The ACUS therefore took no position on whether the split-enforcement model is preferable to a structure in which responsibilities for rulemaking, enforcement and adjudication are combined within a single agency,⁵⁷⁸ as they are at the SEC and CFTC. Similarly, the American Bar Association (“ABA”) assessed whether the FTC should continue to both prosecute and adjudicate antitrust cases. The ABA concluded that the benefits and safeguards inherent in the FTC’s adjudicatory process outweigh any need to separate its prosecutorial and adjudicative functions.⁵⁷⁹

Another perspective is provided by Canada, which lacks a national securities regulator.⁵⁸⁰ Each Canadian province and territory has its own securities regulator, which takes one of two forms. The regulator is either a self-funded commission or an entity housed and financed within a larger government department.⁵⁸¹ These securities commissions have traditionally been structured as multifunctional administrative agencies, in which they act as regulator, investigator, prosecutor, and adjudicator. This is the SEC’s model. In 2004 Quebec opted for a bifurcated or split-enforcement model when it established the Bureau de décision et de révision en valeurs mobilières (“the Bureau”). The Bureau, an independent adjudicative tribunal, rendered ninety decisions between the time it began exercising jurisdiction on February 1, 2004 and June 30, 2008.⁵⁸² Appeals were filed

577 The Split-Enforcement Model for Agency Adjudication (Recommendation No. 86-4), 51 Fed. Reg. 46986 (Dec. 30, 1986).

578 *Id.*

579 Miles W. Kirkpatrick et al., 1989 A.B.A. ANTITRUST SECTION SPECIAL COMMITTEE TO STUDY THE ROLE OF THE FEDERAL TRADE COMMISSION 118 (“[T]he current unity of functions, although troubling, is superior to the alternatives . . .”).

580 See Poonam Puri, *Securities Litigation and Enforcement: The Canadian Perspective*, 37 BROOK. J. INT’L L. 967, 975 (2012) (“Securities experts in Canada have been deliberating over the transition to a national regulator for approximately forty years, with no success to date.”).

581 Thomas Hockin et al., *Final Report and Recommendations*, EXPERT PANEL ON SEC. REG., DEP’T OF FIN. CAN. 39 (2009), http://www.expertpanel.ca/eng/documents/Expert_Panel_Final_Report_And_Recommendations.pdf.

582 Stéphane Rousseau, *The Québec Experience with an Independent Administrative Tribunal Specialized in Securities: A Study of the Bureau de décision et de révision en valeurs mobilières*, EXPERT PANEL ON SEC. REG. IN CAN. 24 (2009), <http://www.expertpanel.ca/documents/research-studies/Quebec%20Independent%20Adjudicative%20Tribunal%20-%20Rousseau.English.pdf>.

with respect to only five of these decisions,⁵⁸³ which certainly suggests that the parties believe the Bureau's process is fair. Quebec's model has been widely endorsed by securities experts in Canada.⁵⁸⁴

At a minimum, the split-enforcement model probably enhances the appearance of fairness.⁵⁸⁵ Balanced against this enhanced appearance is the likely diminution of agency efficiency. Efficiency depends in significant measure on both the existence of a single internal policy-making authority and access by agency decision-makers to the agency's collective expertise and experience.⁵⁸⁶ One study of the OSH Act split-enforcement model concluded that "there is little evidence that these perceived benefits [of increased fairness] outweigh problems with efficiency and policy coordination."⁵⁸⁷ And one indicator of FMSHRC's inefficiency is that it began fiscal year 2016 with a backlog of 4452 undecided cases.⁵⁸⁸

In light of the OSH Act and Mine Act experiences, adoption by the SEC and CFTC of a split-enforcement model likely would incur the cost of reduced efficiency. This is especially undesirable given the sharp constraints on resources confronted by both the SEC⁵⁸⁹ and CFTC. But this conclusion has little or no applicability to the NLRB model, which hinges on a General Counsel acting independently of the NLRB, but in its name and on its behalf, in the pre-filing investigation, issuance, and prosecution of unfair labor practice complaints.

583 *Id.* at 26.

584 *See, e.g.*, Hockin et al., *supra* note 581, at 30 ("We believe that an independent adjudicative tribunal should be established within a framework of a single securities act administered by a single securities regulator for Canada."); Rousseau, *supra* note 582, at 35 ("To summarize, the experience of the Bureau underscores the potential of an independent securities tribunal. It lends support to those who advocate the bifurcated model for securities commissions.").

585 *See* Mintz, *supra* note 571, at 916 ("Is OSHA's split-enforcement arrangement more 'fair'? It would be difficult to say. Does it appear more fair? It seems likely.") (internal quotation marks omitted).

586 *See id.* at 885–86 (describing the split enforcement-model as "a political compromise designed to accommodate the need for effective administration and unified policymaking with concerns about fairness in that administration").

587 Thomas McGarity et al., *Workers at Risk: Regulatory Dysfunction at OSHA*, 2010 CTR. FOR PROGRESSIVE REFORM 20, http://www.progressivereform.org/articles/osha_1003.pdf.

588 FED. MINE SAFETY AND HEALTH REVIEW COMM'N, JUSTIFICATION OF APPROPRIATION ESTIMATES FOR CONG. APPROPRIATIONS: FISCAL YEAR 2017, 11 (Feb. 9, 2016), https://www.fmshrc.gov/plans/FMSHRC_FY%202017%20Congressional%20Justification%2020-09-2017.pdf. *See also* Baker, *supra* note 573, at 646 ("MHSA's policies consistently fail to address the underlying problem—inconsistency and inefficiency within the administrative structure.").

589 *See* James D. Cox, Randall S. Thomas & Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 757 (2003) ("The resource limitations faced by the SEC are a much studied and well understood problem.").

The NLRB model—which has been copied by the EEOC⁵⁹⁰—has been proposed intermittently for decades as an appropriate model for the SEC.⁵⁹¹ It is time to revisit that proposal. Congress should seriously consider separating the prosecutorial and adjudicative functions in the SEC, not by creating separate agencies, but by vesting prosecutorial authority in a General Counsel whose decisions are not subject to Commission review.

C. *Creation of a Right of Removal*

Some federal administrative agencies permit respondents to elect whether to proceed administratively or in federal court. The FERC, for example, provides this option if the alleged violations occurred under Part II of the Federal Power Act (“FPA”).⁵⁹² Before issuing an order assessing a civil penalty against any person under FPA Part II, the FERC issues such person notice of the proposed penalty and a statement of the material facts constituting the violation. The notice gives the person the option to choose between (a) an administrative hearing before a FERC ALJ or (b) an immediate penalty assessment by the FERC which a U.S. district court is authorized to review de novo.⁵⁹³

Analogously, the ABA Task Force recommended more than twenty years ago that respondents in SEC administrative disciplinary proceedings be granted the right to remove most such actions to the United States district court for the district in which the respondent’s principal place of business is located or to the U.S. District Court for the District of Columbia.⁵⁹⁴ This recommendation has been revived as criticism of the SEC has recently intensified. In October 2015 the

590 See EEOC, *Structure of Office of General Counsel*, http://www.eeoc.gov/eeoc/litigation/manual/1-2-a_structure_of_ogc.cfm (last visited Aug. 4, 2016) (describing the functions of the EEOC’s Office of General Counsel). The EEOC General Counsel recommends cases for litigation to the Commission and approves other cases for filing. *Id.*

591 See, e.g., *Task Force Report*, *supra* note 111, at 1737 (“This approach preserves the agency’s important role in ensuring that the law develops and is applied uniformly, while at the same time avoiding the combination of functions that raises serious questions of fairness.”); Paul R. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 DUKE L.J. 257, 267 (“The experience of the NLRB with a general counsel who is separately subject to presidential appointment might be a model worth emulating by agencies like the FTC and SEC.”).

592 Regulation of Electric Utility Companies Engaged in Interstate Commerce, 16 U.S.C. §§ 824-824v (2012).

593 16 U.S.C. § 823b(d)(2)(A)-(B) (2012); William J. Scherman, Brandon C. Johnson & Jason J. Fleischer, *The FERC Enforcement Process: Time for Structural Due Process and Substantive Reforms*, 35 ENERGY L.J. 101, 110 (2014).

594 *Task Force Report*, *supra* note 111, at 1736.

Due Process Restoration Act of 2015 was introduced in Congress.⁵⁹⁵ The bill—written as an amendment to the Exchange Act—allows respondents to terminate APs (thereby forcing the SEC to either re-file the claims in an Article III court or dismiss them) and raises the burden of proof for the SEC in administrative proceedings to require clear and convincing evidence that a respondent has violated the securities laws.⁵⁹⁶

A number of observers have endorsed a right of removal, including former SEC Chairman Christopher Cox.⁵⁹⁷ According to Cox, adoption by Congress of a right of removal likely would result in a middle ground between the pre-Section 929P(a) world and the current environment of significantly expanded use by the SEC of APs.⁵⁹⁸ Cox is wrong. Creating a right of removal is unlikely to result in a middle ground. Rather, vesting respondents with the option to remove would create a situation in which most of them, when confronted with the prospect of administrative enforcement, probably would threaten to exercise the option as leverage in settlement discussions with the SEC and CFTC.⁵⁹⁹ And given the resource constraints faced by the agencies, that threat would be powerful enough to disrupt the settlement calculus in hundreds of cases every year. Granting a right of removal also is likely to have the unintended negative consequence of multiplying the already taxing case load burden on the federal judiciary. Overall, removal is ill-advised.

595 H.R. 3798, 114th Cong. (2015); Cara Salvatore, *Bill Aims to Cut In-House Proceedings for SEC Violations*, LAW360 (Oct. 22, 2015, 8:38 PM), <http://www.law360.com/articles/717392/print?section=assetmanagement>.

596 H.R. 3798, 114th Cong. (2015).

597 See Cox, *supra* note 24, at 8 (recommending adoption of right of removal). Accord U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 20 (recommending adoption of right of removal); Joseph Quincy Patterson, Note, *Many Key Issues Left Unaddressed in the Securities and Exchange Commission's Attempt to Modernize its Rules of Practice*, 91 NOTRE DAME L. REV. 1675, 1702 (2016) (same).

598 Cox, *supra* note 24, at 8.

599 See Henning, *supra* note 213 (“The Chamber of Commerce’s suggestion that defendants be allowed to take a case to federal court is unlikely to gain any support from the S.E.C. Virtually every defendant facing potential administrative charges would threaten to use that option as a lever to gain a more favorable settlement.”). See also *Fair or Foul? SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation: Hearing on H.R. 3798 Before the Subcomm. on Capital Markets and Gov’t Sponsored Enterprises of the H. Comm. on Fin. Servs.*, 114th Cong. 7 (2015) (statement of Joseph A. Grundfest, William A. Franke Professor of Law and Business, Stanford Law School), <http://financialservices.house.gov/uploadedfiles/hhr-114-ba16-wstate-jgrundfest-20151202.pdf> (noting that Due Process Restoration Act of 2015 could effectively eliminate APs as a mechanism for resolving significant securities fraud cases); Platt, *supra* note 500, at 47 (concluding that if respondents are granted a right of removal they “would likely opt out of the AP system very widely”).

D. Amendment of the SEC and CFTC Rules of Practice

In June 2014 the SEC's General Counsel acknowledged that the agency's RoP were last revised "quite some time ago," and indicated the agency may be open to modernizing them.⁶⁰⁰ In fact, prior to 2016 the SEC RoP were last amended in 2006⁶⁰¹—four years before Dodd-Frank greatly expanded the SEC's authority to use administrative enforcement—and they were last materially updated in the mid-1990s.⁶⁰² The last material update occurred long before the modern explosion of electronically-stored information ("ESI"). The SEC's failure to revise the RoP to reflect the harsher aspects of the current enforcement regime has placed respondents at a significant litigation disadvantage. The same is true with regard to the CFTC RoP. The litigation disadvantage is not unconstitutional but it is unfair. A number of critics have called for reform⁶⁰³ and these critics are correct.

In September 2015 the SEC announced that it had voted to propose amendments to its RoP.⁶⁰⁴ After receiving thirteen comment letters in response to the proposal,⁶⁰⁵ the SEC made minor revisions and adopted amendments in July 2016.⁶⁰⁶ The amendments—which took effect on September 27, 2016 and apply to all APs initiated on or af-

600 Stephanie Russell-Kraft, *Attys Ready to Pounce on SEC's Outdated Admin Rules*, LAW360 (June 18, 2014, 7:00 PM), <http://www.law360.com/articles/549549/attys-ready-to-pounce-on-sec-s-outdated-admin-rules>.

601 See SEC, ADOPTION OF AMENDMENTS TO THE RULES OF PRACTICE AND RELATED PROVISIONS AND DELEGATIONS OF THE AUTHORITY OF THE COMM'N, Release Nos. 34-52846, File No. S7-05-05 (Nov. 29, 2005), <https://www.sec.gov/rules/final/34-52846.pdf> (indicating effective date of Jan. 4, 2006); William F. Johnson, *SEC Behind Times in "Modernizing" Administrative Proceedings*, N.Y. L.J. (Nov. 5, 2015) ("Indeed, the SEC's Rules of Practice were last updated almost ten years ago, in 2006, before the Dodd-Frank Act broadened the SEC's ability to bring more cases in the administrative forum.")

602 U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *supra* note 26, at 16 (noting that the SEC completed its most recent "material update" of the RoP in 1994).

603 See, e.g., McLucas & Martens, *supra* note 531 ("[T]he agency should move swiftly to modernize the rules of procedure governing its in-house proceedings.")

604 See Press Release, Securities and Exchange Commission, *SEC Proposes to Amend Rules Governing Administrative Proceedings* (Sept. 24, 2015), <http://www.sec.gov/news/pressrelease/2015-209.html>.

605 The comment letters are located at <http://www.sec.gov/comments/s7-18-15/s71815.shtml>.

606 See Securities and Exchange Commission, Press Release 2016-142, *SEC Adopts Amendments to Rules of Practice for Administrative Proceedings* (July 13, 2016), <https://www.sec.gov/news/pressrelease/2016-142.html>.

ter that date⁶⁰⁷—are an incremental step in the right direction, but they fail to cure the fundamental defects in the SEC’s administrative process. The SEC and CFTC should revise their respective Rules of Practice in the following respects.

First, both sets of rules should be amended to permit expanded discovery. In particular, the rules should be amended to permit additional fact and expert depositions. As noted, the CFTC currently permits depositions only to preserve the testimony of witnesses unlikely to be available for hearing, and this was the SEC’s rule prior to the September 2016 amendments. Expanding the scope of permissible depositions to permit respondents in SEC and CFTC administrative proceedings to cross-examine the agencies’ witnesses prior to trial could accomplish multiple goals: (1) respondents could better assess the merits of the agencies’ cases, (2) both sides could better evaluate settlement prospects, and (3) respondents could better formulate their own trial strategy. Expanding the scope of permissible depositions to encompass potential witnesses the SEC and CFTC may not have identified or pursued during their investigations could further accomplish the foregoing goals.

The SEC’s 2015 announcement included a proposed amendment to Rule 233. The proposal provided that in matters with one respondent, each side may notice for deposition a maximum of three persons and in matters where there are multiple respondents each side may depose up to five persons.⁶⁰⁸ The Division is one side and the group of all respondents is the other side. The limitations encompassed both fact and expert witnesses. Each deposition was limited to one day of six hours, including cross-examination,⁶⁰⁹ although this time could be expanded by the ALJ or Commission upon a showing—among other reasons—that more time is required to fairly examine the deponent.

After receiving comments, the SEC modified its proposed amendment in minor respects. In the revised version, the maximum length of each deposition was extended by one hour and each side

⁶⁰⁷ Cadwalader, Wickersham & Taft, LLP, *The SEC Retains its House Advantage During Administrative Proceedings*, NAT’L L. REV. (Aug. 5, 2016), <http://www.natlawreview.com/article/sec-retains-its-house-advantage-during-administrative-proceedings>.

⁶⁰⁸ Amendments to the Commission’s Rules of Practice, 80 Fed. Reg. 60,091, 60,102 (proposed Oct. 5, 2015).

⁶⁰⁹ *Id.* at 60,103.

can seek leave from the ALJ to take two additional depositions upon a showing of compelling need.⁶¹⁰

The SEC's new rule is much too restrictive, in several respects. To begin, the core limit of three depositions in single respondent cases and five depositions in multiple respondent cases is too low, especially in complex cases.⁶¹¹ One obvious aspect of the inadequacy concerns the mix of fact and expert witnesses. Experts can play a central role in complex cases. If the Enforcement Division discloses two expert witnesses in a single respondent case, the respondent effectively is limited to a single fact witness,⁶¹² assuming the ALJ fails to grant leave. The inadequacy is further underscored by comparing amended Rule 233 to the number of depositions available in federal district court and to the number of witnesses the Enforcement Division typically calls in administrative hearings. Parties are granted ten depositions by the FRCP⁶¹³ and often take many more in complex cases, pursuant to leave of court.⁶¹⁴ The Division calls an average of eight or nine witnesses in APs,⁶¹⁵ and this number likely reflects a subset of the

610 See Daniel V. Ward, Jon A. Daniels & Alexandria Perrin, *Inside SEC's New In-House Court Rules*, LAW360 (Aug. 1, 2016, 11:54 AM), <http://www.law360.com/articles/823479/inside-sec-s-new-in-house-court-rules> (describing the new provisions).

611 See, e.g., Peter J. Henning, *A Small Step in Changing S.E.C. Administrative Proceedings*, N.Y. TIMES: DEALBOOK (Sept. 28, 2015), http://www.nytimes.com/2015/09/29/business/dealbook/a-small-step-in-changing-sec-administrative-proceedings.html?_r=0 (“[A]llowing only three—or at most five—depositions seems like an artificially low limit that will not do much to aid those accused of a violation in a complex case.”); GIBSON DUNN & CRUTCHER, *SEC Moves in the Right Direction with Proposed Amendments to Rules Governing Administrative Proceedings, but the Changes Do Not Go Far Enough* (Sept. 28, 2015), <http://www.gibsondunn.com/publications/pages/SEC-Proposed-Amendments-to-Rules-Governing-Administrative-Proceedings.aspx> (“[I]n complex cases, which the Commission has increasingly authorized to proceed in its in-house courts, three or five depositions per side could be woefully inadequate, especially in proceedings against multiple respondents, who may have widely divergent interests and significant differences of opinion as to which witnesses should be deposed.”).

612 Navistar International Corporation, Comments on Proposed Rule: Amendments to the Commission's Rules of Practice [Release No. 34-75976; File No. S7-18-15], 2015 WL 8489929, at *3 (S.E.C. Misc. Dec. 3, 2015).

613 See FED. R. CIV. P. 30(a)(2)(A)(i) (providing that leave of court is necessary when taking a deposition would result in more than ten depositions being taken).

614 *Why the SEC's Proposed Changes to its Rules of Practice are Woefully Inadequate—Part II*, SEC. DIARY (Nov. 5, 2015), <http://securitiesdiary.com/2015/11/05/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-ii/> (“[I]n factually challenging cases, it would not be unusual to have ten to thirty fact depositions in a federal court case, followed by at least two expert depositions per side.”).

615 Johnson, *supra* note 601 (“[A] look at the administrative hearings held over the past year reveals an average of eight witnesses called by the Enforcement Division.”); Richard Foster, Senior V.P. and Senior Counsel for Regulatory and Legal Affairs, Financial Services Roundtable, Comment Letter on Proposed Amendments to the Commission's Rules of

much larger universe of witnesses who were deposed or interviewed by the Division before the OIP was filed.⁶¹⁶

Creating symmetry by giving the Division and respondents an equal number of deposition slots will do little or nothing to even the playing field, because prior to filing of the OIP there is great asymmetry—the Division, with unlimited authority to subpoena witnesses and documents, is not unlikely to take dozens of examinations under oath.⁶¹⁷ The Division can do this without the participation or even knowledge of future respondents. Moreover, where there are multiple respondents they may have widely divergent interests and views about who should be deposed under the new rule.⁶¹⁸ Finally, amended Rule 233 does not contemplate that SEC investigative personnel can be deposed, or that SEC files previously not subject to discovery could be discoverable.

At a minimum, Rule 233 should be further modified to significantly increase the capped number of deposition slots, grant SEC ALJs the discretion to consider the complexity of a proceeding in determining the appropriate number of depositions, or treat expert witnesses as a separate category.⁶¹⁹ In addition, the SEC should con-

Practice (Dec. 4, 2015), <https://www.sec.gov/comments/s7-18-15/s71815.shtml> (“The Division regularly calls nine or more witnesses in administrative proceedings.”).

616 See Tom Quaadman, Senior V.P., Ctr. for Capital Mkts. Competitiveness, Comment Letter on Proposed Amendments to the Commission’s Rules of Practice, 7–8 (Dec. 4, 2015), <https://www.uschamber.com/sites/default/files/documents/files/2015-12.4-rules-of-practice-comment-letter.pdf> (“Anecdotally, it is common for the staff to interview or depose literally dozens of witnesses in a typical investigation.”); *Why the SEC’s Proposed Changes to its Rules of Practice are Woefully Inadequate—Part II*, SEC. DIARY 2 (Nov. 5, 2015), <http://securitiesdiary.com/2015/11/05/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-ii/> (stating that it would not be unusual for the Enforcement Division to take testimony from fifteen to thirty witnesses during the course of an investigation).

617 See Peter K.M. Chan & Amy C. Greer, *Tweaking the “Home Court” Rules for SEC Administrative Proceedings*, MORGAN LEWIS & BOCKIUS LLP (Sept. 28, 2015), <http://www.morganlewis.com/pubs/tweaking-the-home-court-rules-for-sec-administrative-proceedings> (“The effect will be to leave the playing field tilted in favor of the Division.”).

618 Barry R. Goldsmith, *SEC Proposed Amendments to Rules for Administrative Proceedings*, HARV. LAW SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. 2 (Oct. 15, 2015), <http://corpgov.law.harvard.edu/2015/10/15/sec-proposes-amendments-to-rules-for-administrative-proceedings/> (noting woeful inadequacy of allowing a maximum of five depositions per side in complex cases, especially those involving multiple respondents).

619 See COVINGTON & BURLING LLP, *The SEC’s Proposed Modernization of its Rules for Administrative Proceedings* 2 (Sept. 28, 2015), https://www.cov.com/~/_media/files/corporate/publications/2015/09/the_secs_proposed_modernization_of_its_rules_for_administrative_proceedings.pdf (“[T]here will inevitably be cases in which arbitrary limits to the number of depositions and hearing preparation time will deprive respondents of a fair opportunity to defend themselves.”).

sider allowing the limited use of interrogatories and requests for admissions.

Second, both agencies should amend their rules to expressly adopt the full version of the *Brady* rule. As noted, whereas SEC RoP 230(b)(2) prohibits the Division from withholding documents that contain material exculpatory evidence, the rule does not impose an affirmative duty to identify or disclose such evidence.⁶²⁰ Both the SEC and CFTC should expressly impose such an obligation on their staffs during the course of administrative proceedings. The SEC's new amendments do not address the *Brady* rule.

Third, the compressed timelines adopted by the SEC should be further relaxed. As noted, most SEC APs proceed under the 300-day timeline, which provides for a hearing to occur 120 days from filing of the OIP. This timeline, and the two alternatives, were adopted in 2003, prior to the dramatic expansion under Dodd-Frank of the SEC's administrative enforcement authority. These timelines are anachronistic and should be extended to reflect both the sea-change wrought by Dodd-Frank and the modern explosion of ESI.

The SEC's September 2015 announcement included a proposed amendment to Rule 360 that would expand the foregoing timeline, but not by much. For example, proposed amended Rule 360 would permit an administrative hearing in a 300-day case to be scheduled up to eight months following the service of the OIP, thereby doubling the former deadline of four months.⁶²¹ This proposed expansion was insufficient to reduce the advantage currently enjoyed by the SEC,⁶²² particularly when compared with the schedules in comparably complex federal district court cases.⁶²³ For the twelve month period ending June 30, 2015, the median time in federal civil cases from the

⁶²⁰ Goetz, *supra* note 243, at 1436–37.

⁶²¹ *Amendments to the Commission's Rules of Practice*, SEC Rel. No. 34-75976, at 54 (Sept. 24, 2015), <http://www.sec.gov/rules/proposed/2015/34-75976.pdf>.

⁶²² See GIBSON DUNN & CRUTCHER, *supra* note 611, at 2 (“While these amendments commendably would provide respondents with additional time to prepare for their hearings, they do not adequately remedy the discrepancy between the far longer time period the Division of Enforcement allows itself to investigate and prepare its case, which frequently is measured in years rather than months.”).

⁶²³ See Olson, *supra* note 129, at 3–4 (“[T]he proposed increase from four to eight months in trial preparation time for complex matters is still far short of what is needed for the most complicated proceedings.”). See also Breon Peace & Lisa Vicens, *Fighting the SEC on its Home Turf*, LAW360 (Oct. 28, 2016, 11:42 AM), <http://www.law360.com/assetmanagement/articles/854404/fighting-the-sec-on-its-home-turf> (noting that longer pre-hearing period under amended SEC RoP “is still much shorter than it would be in a federal civil court”).

time of filing a complaint to trial was twenty-six and a half months,⁶²⁴ and the SEC's five jury trials in fiscal year 2015 took between thirty-four and sixty-six months from the time of filing the complaint to the verdict.⁶²⁵

In response to comments received after the amendment was proposed the SEC made slight revisions. The revised rule extends the length of the pre-hearing period to a maximum of ten months in 300-day cases, six months in 210-day cases, and four months in 120-day cases.⁶²⁶ This extension remains inadequate.⁶²⁷ At a minimum, Rule 360 should be further amended to permit either longer or more flexible time periods. Rule 16 of the FRCP vests federal district judges with the discretion to issue scheduling orders that reflect the complexity of cases and the scheduling needs of the parties,⁶²⁸ and Rule 360 of the RoP should include an analogous provision.

Fourth, the RoP amendments fail to assure respondents in SEC APs timely access to the Division's investigative file. As noted, under Rule 230(a), the Division must commence making its file available to respondents no later than seven days after service of the OIP. There is no deadline for completion, and in theory full disclosure could take much longer. Indeed, "the Division's production can be and often is accomplished piecemeal over time, further reducing preparation for the respondent."⁶²⁹ Whether or not a piecemeal production is common, the Division's file should be made available to respondents before the OIP is filed. Such earlier disclosure could render Wells submissions more useful, provide respondents with an enhanced ability to evaluate their case at an earlier stage of the proceedings, and prompt earlier and possibly more fruitful settlement discussions.⁶³⁰ Amended Rule 221(c) adds to the list of subjects to be discussed at an AP's pre-hearing conference the timing for completion of the disclosure required by Rule 230,⁶³¹ but it does not mandate either prompt disclosure or disclosure before the OIP is filed.

624 Foster, *supra* note 615, at 5.

625 *Id.*

626 Margaret A. Dale & Mark D. Harris, *SEC Adopts Amendments to Rules for Administrative Proceedings*, N.Y. L.J. (Aug. 10, 2016).

627 *Id.* ("[T]he disparity between the parties is still large. Ten months is a relatively short time for respondents to prepare for a complex trial, particularly where the SEC has had years to investigate, collect documentary evidence, and take testimony.").

628 *See* FED. R. CIV. P. 16.

629 Olson, *supra* note 129, at 5.

630 GIBSON, DUNN & CRUTCHER, LLP, *supra* note 611, at 2.

631 JONES DAY, *SEC Publishes Final Rules Amending the Rules of Practice for Administrative Proceedings 2* (July 2016), <http://www.jonesday.com/sec-publishes-final-rules-amending-the-rules-of-practice-for-administrative-proceedings-07-19-2016/>.

Overall, the Commission's September 2016 amendments to its RoP fail to mitigate to any appreciable degree the unfairness inherent in the current rules.⁶³²

CONCLUSION

Dodd-Frank authorized the SEC to impose civil penalties in proceedings before an ALJ against any person who violated any provision of the federal securities laws or any rule promulgated under those statutes. This authorization has resulted in a classic case of administrative creep at the SEC. More than 80% of the SEC's new enforcement actions in the first three quarters of fiscal year 2016 were filed as administrative proceedings, and the CFTC plans to follow suit.

SEC ALJs are SEC employees and are paid by the agency. They are not appointed by the President, a court of law, or the head of a federal department, and they arguably are insulated from the President by dual layers of for-cause removal protection. If an SEC enforcement action is assigned to an ALJ, rather than to a federal judge, there are major adverse procedural consequences for respondents. There is very limited discovery, neither the FRE nor the FRCP apply, there is no opportunity to assert counterclaims, there is no right to a jury trial on any issue, and the time frame for completion of the administrative proceeding is both rigid and truncated.

The SEC has been much more successful in APs conducted on its home court than it has been in federal court. During the time period October 2010 to September 2015, the SEC prevailed against 86% of respondents in contested cases heard by ALJs, whereas during the same period the SEC had a considerably lower success rate of 70% in federal court. The statistics concerning appeals are even starker.

The foregoing picture has prompted a number of respondents to file constitutional challenges to SEC administrative proceedings. Five of the most common constitutional arguments asserted by respondents are denial of due process, denial of equal protection, violation of the Seventh Amendment, and two distinct violations of Article II of the Constitution. Virtually none of these arguments has merit. The only meritorious constitutional argument is that SEC ALJs have been

⁶³² See Carmen Germaine, *SEC Faces Long Road Ahead on Admin Court Reforms*, LAW 360 (July 13, 2016, 9:54 PM), <http://www.law360.com/articles/816979/sec-faces-long-road-ahead-on-admin-court-reforms> (quoting Baker Botts, LLP partner Jonathan Shapiro for the proposition that amendments to SEC RoP represent non-comprehensive "textbook incrementalism"); Elizabeth P. Gray et al., *Will the Securities and Exchange Commission's Proposed Changes to Administrative Proceedings Quiet Critics?*, 22 THE INVESTMENT LAWYER 1, 6 (Dec. 2015) ("[T]he changes will not eliminate the due process concerns that have been raised.").

appointed in violation of Article II. The SEC should cure that defect by having its Commissioners reappoint its ALJs. In addition to the constitutional arguments, there are some core normative arguments—the process impedes the development of the federal securities laws and even if the process is constitutional it is unfair, or at least raises a substantial perception of unfairness. The fairness argument is much more compelling than the developmental argument. The SEC AP process is fundamentally unfair. Congress should seriously consider adopting the NLRB model for the SEC, whereby an independent General Counsel would make investigative and prosecutorial decisions, and the SEC and CFTC should revise their respective Rules of Practice.