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SEC Enforcement Discretion

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I. Introduction

In *Enforcement Discretion at the SEC*,[1] Professor David Zaring makes a valuable contribution to our understanding of administrative proceedings (APs) conducted by the Securities and Exchange Commission (SEC). The expanded use of APs by the SEC has become one of the most controversial topics in securities enforcement. The expansion was sparked by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).[2] Dodd-Frank authorized the 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.[3] Prior to Dodd-Frank, the SEC's authority to impose civil penalties in an AP was limited to registered entities and persons associated with registered entities—primarily broker-dealers and investment advisers. Given this restriction, the SEC historically commenced only 60% of its new cases as APs.[4] Post-Dodd-Frank, that percentage has significantly increased. More than 80% of the SEC's "new enforcement actions in the first half of fiscal year 2015 were filed as

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1. David Zaring, *Enforcement Discretion at the SEC*, 94 TEXAS L. REV. 1155 (2016).
2. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
3. *See id.* § 929P.
4. Sara Gilley, Heather Lazur & Alberto Vargas, *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360 (May 27, 2015, 10:25 AM), http://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup [https://perma.cc/22K7-82X2].

administrative proceedings."[5] The trend is even starker 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.[6]

Professor Zaring argues that SEC administrative hearings are virtually identical to federal district court trials,[7] but the overall experience in the two actions is substantially different. In APs there is no opportunity to move to dismiss or assert counterclaims, there is very limited discovery, neither the Federal Rules of Evidence nor the Federal Rules of Civil Procedure apply, hearsay evidence is generally admissible, there is no right to a jury trial on any issue, and the time frame for completion of the proceeding is remarkably compressed.[8]

Professor Zaring argues that consternation about the SEC's procedures is misplaced because the "SEC does not always win before its ALJs."[9] It is true that the SEC does not always win in-house, but the lack of guaranteed success does not mean there is no cause for concern. During the period from October 2010 to March 2015, the SEC prevailed against 90% of respondents in contested cases heard by ALJs,[10] and in the same period the SEC had a considerably lower success rate of 69% in federal court.[11] Professor Zaring argues that many of the opinions rendered by ALJs are rendered after defaults,[12] and this too is true, but the fact remains that in contested cases the SEC enjoys a much higher success rate on its home turf than it does in federal court. It is reasonable to speculate that the SEC's procedural rules—tilted as they are in favor of the agency—explain a significant portion of the difference.

The uneven playing field and other factors have prompted numerous respondents to file constitutional challenges to SEC administrative proceedings.[13] Professor Zaring examines several of the key constitutional

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5. *Id.*

6. STEPHEN CHOI, SARA E. GILLEY & DAVID F. MARCUS, NYU POLLACK CENTER FOR LAW & BUSINESS AND CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY AGAINST PUBLIC COMPANY DEFENDANTS: FISCAL YEARS 2010–2015, at 6 (2016), https://www.cornerstone.com/GetAttachment/5c823caf-b6b7-47b5-ba2f-1c991fef68c7/SEC-Enforcement-Activity-Against-Public-Company-Defendants.pdf [https://perma.cc/5VWA-5B5V].

7. Zaring, *supra* note 1, at 1198.

8. *See generally* 17 C.F.R. §§ 201.100–201.900 (2015).

9. Zaring, *supra* note 1, at 1172.

10. Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015), http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803 [https://perma.cc/NA92-ZCVV].

11. *Id.*

12. *See* Zaring, *supra* note 1, at 1179–80.

13. *See* 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 [https://perma.cc/88T6-68P3] (noting that approximately a dozen defendants have asserted constitutional challenges in federal court).

arguments and concludes that such arguments are meritless. However, he does not examine what I believe is the best constitutional argument advanced to date by respondents, and this omission is my first major point of departure with his doctrinal analysis. The best argument, explained below, is that the SEC's appointment of its ALJs violates the Appointments Clause of Article II of the United States Constitution.[14]

My second major doctrinal disagreement with Professor Zaring concerns his discussion of what I regard as a false dichotomy between an expectation by respondents and their counsel that APs will be conducted fairly, and the orientation by SEC ALJs that procedural regularity trumps equity. As I explain, SEC APs are fundamentally unfair, but this unfairness is not compelled by the Administrative Procedure Act (APA),[15] which governs SEC APs and other federal administrative adjudications. The SEC could choose to substantially reduce procedural unfairness in its administrative proceedings without sacrificing procedural regularity or violating the APA.

II. The SEC AP Process

Given the choice between judicial and administrative venues, how does the SEC decide? Professor Zaring asserts that the SEC has explained its decision calculus,[16] but this is not quite correct. In May 2015 the SEC's Division of Enforcement 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.[17] The widely criticized memorandum, which was not issued by the Commission and thus does not represent Commission-level policy,[18] identifies four factors that the Division may consider when deciding whether to pursue an enforcement action in federal district court or as an administrative proceeding before an SEC ALJ. These factors are: (1) "[t]he availability of the desired claims, legal theories, and forms of relief in each forum;" (2) "[w]hether any charged party is a registered entity or an individual associated with a registered entity;" (3) "[t]he cost-, resource-, and time-effectiveness of litigation in each forum;" and (4) the "[f]air, consistent, and effective resolution of securities law

14. *See infra* Part III.

15. Administrative Procedure Act, Pub. L. No. 79-404, 60 Stat. 237 (1946).

16. Zaring, *supra* note 1, at 1207.

17. SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS, http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf [https://perma.cc/3TBQ-FSVY].

18. Christopher Cox, Partner, Morgan, Lewis & Bockius, Address at Securities Enforcement Forum West: The Growing Use of SEC Administrative Proceedings: An Historical Perspective from Congress and the Agency 4 (May 13, 2015), http://www.securitiesdocket.com/wp-content/uploads/2015/05/2015-05-13-Speech-to-Securities-Enforcement-Forum-West-San-Francisco.pdf [https://perma.cc/7S8D-9A3G].

issues and matters."[19] The Division has indicated that the foregoing factors are non-exhaustive, some or all of them may be considered in a particular case, and a single factor may be dispositive.[20] Accordingly, the document establishes no fundamental limitations on the SEC's exercise of discretion.[21]

SEC APs are governed by the agency's Rules of Practice (RoP).[22] Prior to 2016 the RoP were last amended in 2006[23]—four years before Dodd-Frank dramatically expanded the SEC's authority to use an administrative forum. The SEC commences an administrative proceeding with an Order Instituting Proceedings (OIP), which sets forth the Division's allegations against the respondent(s) and serves as the charging document.[24] The 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.[25] The selection of one of the three options is based on the "nature, complexity, and urgency of the subject matter."[26] The majority of contested SEC administrative proceedings are "sufficiently complex to warrant the 300-day" timeline.[27] When that timeline does apply, the ALJ is required by

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19. SEC. & EXCH. COMM'N, *supra* note 17.

20. Andrew Ceresney, Director, SEC Division of Enforcement, Keynote Address at New York City Bar Fourth Annual White Collar Institute (May 12, 2015), http://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html [https://perma.cc/6NJF-DS5T] (explaining the new guidance); Thomas A. Hanusik, *What's Missing from the SEC's Forum Selection Guidance*, LAW360, at 1 (May 21, 2015, 10:34 AM), http://www.crowell.com/files/Whats-Missing-From-The-SECs-Forum-Selection-Guidance.pdf [https://perma.cc/399F-9CSJ] (describing the factors as "nonexhaustive, nonmandatory and unweighted").

21. *See, e.g.*, *SEC Enforcement Division Issues Guidance on Venue Selection*, CLIENT ALERT COMMENTARY (Latham & Watkins), May 18, 2015, at 1, https://www.lw.com/thoughtLeadership/lw-sec-guidance-choice-of-venue [https://perma.cc/QWK2-LXGP] ("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."); Randall J. Fons, *Administrative Proceedings vs. Federal Court: The SEC Provides Limited Transparency into Its Choice of Forum*, CLIENT ALERT (Morrison & Foerster), May 11, 2015, at 1, http://www.mofo.com/~/media/Files/ClientAlert/2015/05/150511SECChoiceofForum.pdf [https://perma.cc/JZ5K-V3CB] ("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.'").

22. Jarkesy v. S.E.C., 803 F.3d 9, 12 (D.C. Cir. 2015); 17 C.F.R. §§ 201.100–.900 (2015).

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

24. 17 C.F.R. § 201.200 (2015).

25. *Id.* § 201.360.

26. *Id.*

27. Luke T. Cadigan, *Litigating an SEC Administrative Proceeding*, 58 BOS. BAR J. (Jan. 7, 2014), http://bostonbarjournal.com/2014/01/07/litigating-an-sec-administrative-proceeding/ [https://perma.cc/YQM7-7MVF].

the RoP to schedule the hearing for a date approximately four months from service of the OIP.[28]

There is very limited discovery during an SEC administrative proceeding. In general, neither interrogatories nor discovery depositions are allowed, even in complex cases.[29] A deposition upon oral or written examination may be allowed if the witness will be unable to attend or testify at the hearing,[30] but the ALJ retains discretion to deny such requests and in practice ALJs seldom allow depositions.[31]

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.[32] This luxury is not theoretical—approximately 40% of the SEC's cases are filed more than two years after the agency begins an investigation,[33] and during those years the SEC, aided by an expansive subpoena power,[34] is able to conduct numerous depositions and collect a huge volume of documents. In short, the SEC staff is able to effectively conduct its pre-hearing discovery before the proceeding commences.[35]

Professor Zaring asserts that the inability of respondents to take depositions in SEC APs "differs little" from the situation in federal district court,[36] but I disagree. The general inability of respondents in administrative proceedings to depose any witnesses stands in stark contrast to the ability of defendants in federal district court to depose both fact and

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28. 17 C.F.R. § 201.360 (2015).

29. MARC B. DORFMAN & KENNETH B. WINER, SECURITIES ENFORCEMENT: COUNSELING AND DEFENSE § 19.04[6] (2014); SEC. & EXCH. COMM'N, RULES OF PRACTICE, RULE 233, cmt. (July 2003), https://www.sec.gov/about/rulesprac072003.htm#233 [https://perma.cc/YVR7-9GB6] (depositions "are not allowed for purposes of discovery").

30. 17 C.F.R. § 201.233(a), 234(a) (2015).

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

32. *See* ALAN R. BROMBERG, LEWIS D. LOWENFELS & MICHAEL J. SULLIVAN, 6 BROMBERG & LOWENFELS ON SECURITIES FRAUD § 12.55 (2d ed.) (database updated Dec. 2015) ("The SEC staff has had the benefit of discovery through its extensive investigative powers."); John Falvey & Daniel Tyukody, Duka *Will Slow, Not Stop, SEC's In-House Court Trend*, LAW360 (Sept. 8, 2015, 11:01 AM), http://www.law360.com/articles/699283/duka-will-slow-not-stop-sec-s-in-house-court-trend [https://perma.cc/C6UX-63XM] ("[T]he SEC will often have developed its investigative record, including extensive witness testimony, over a period of years.").

33. CTR. FOR CAPITAL MKTS. COMPETITIVENESS, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES 39 (July 2015), http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf [https://perma.cc/AL9W-G5SZ].

34. *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 [https://perma.cc/YP6X-ZCLS] ("[T]here are few restrictions on the SEC's subpoena power.").

35. *See* CTR. FOR CAPITAL MKTS. COMPETITIVENESS, *supra* note 33, at 15.

36. Zaring, *supra* note 1, at 1167.

expert witnesses.[37] This is a critical difference between the two types of actions.

The SEC has justified the propriety of narrow discovery in administrative proceedings by comparing the process to criminal cases, and Professor Zaring makes the same comparison.[38] Whereas prosecutors have the benefit of grand jury discovery, strictly limited discovery is available to criminal defendants.[39] 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,[40] and this is the same isolated scenario in which depositions are allowed by the SEC's RoP.[41] However, the SEC's analogy is undercut because criminal defendants enjoy major safeguards unavailable to SEC respondents—in particular, no adverse inference can be drawn from the assertion of the Fifth Amendment privilege against self-incrimination,[42] the government has the burden of proving its case beyond a reasonable doubt, and defendants have the right to a jury trial.[43]

The SEC has further defended the narrow discovery in its administrative proceedings by emphasizing that when it discloses to respondents material exculpatory evidence under *Brady v. Maryland*[44] the Enforcement Division provides more expansive discovery in administrative proceedings than it does in federal district court,[45] and Professor Zaring advances the same argument.[46] In *Brady* the Supreme Court held that "the

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37. *See* FED. R. CIV. P. 26(b) (2012).

38. Zaring, *supra* note 1, at 1167.

39. *See, e.g.*, Andrew Ceresney, Director, SEC Division of Enforcement, Remarks at American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297 [https://perma.cc/X57T-9KSQ] ("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 where someone's liberty is on the line, then it is hard to see how due process requires more for respondents in administrative proceedings.").

40. FED. R. CRIM. P. 15(a)(1) (2015).

41. 17 C.F.R. § 201.233(a) (2015).

42. *See, e.g.*, Baxter v. Palmigiano, 425 U.S. 308, 317 (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 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.'" (quoting *Baxter*, 425 U.S. at 318)).

43. 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 [https://perma.cc/C6CQ-YGXL].

44. 373 U.S. 83 (1963).

45. *See, e.g.*, Ceresney, *supra* note 39 ("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.").

46. Zaring, *supra* note 1, at 1169.

suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or punishment."[47] The Supreme Court has not decided whether *Brady* should apply to the government in civil cases,[48] and the SEC has chosen not to impose *Brady* obligations on its staff in such cases. The SEC does impose such obligations in administrative proceedings,[49] even though most other federal agencies do not.[50]

The SEC's *Brady* argument has superficial appeal but ultimately is unconvincing. The Enforcement Division and defense counsel may have widely divergent views of what constitutes *Brady* material with the likely result that that some or even much material evidence is withheld. 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 (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."[51]

III. Constitutional Arguments

Professor Zaring analyzes some of the key constitutional arguments advanced against SEC administrative proceedings and concludes that the most successful claim, and the most novel one, is based on the Supreme Court's 2010 decision in *Free Enterprise Fund v. PCAOB* (*Free Enterprise*).[52] I disagree on both counts.

In *Free Enterprise* the Court held that the Public Company Accounting Oversight Board (PCAOB) was improperly constituted because its members were insulated by statute from the President by two layers of limitations on removal.[53] There were two layers because PCAOB members could only be removed for cause,[54] and the Supreme Court accepted the parties' stipulation that those individuals who could remove the members—the SEC Commissioners—could also only be removed for cause.[55] The

47. *Brady*, 373 U.S. at 87.

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

49. 17 C.F.R. § 201.230(b)(2) (2015).

50. 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.").

51. 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, 117 (2014).

52. 561 U.S. 477 (2010); Zaring, *supra* note 1, at 1191.

53. 561 U.S. at 513–14.

54. *Id.* at 486.

55. *Id.* at 487.

Supreme Court had previously held that one level of for-cause removal protection was constitutional,[56] but in *Free Enterprise* it held that dual layers was one too many for the PCAOB.[57]

Respondents in SEC administrative proceedings have cited *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.[58] ALJs can only be removed for cause by SEC Commissioners,[59] with the consent of the Merit Systems Protection Board (MSPB),[60] and as noted above, the Supreme Court stated in *Free Enterprise* that SEC Commissioners can only be removed for cause.

Respondents' argument has been uniformly unsuccessful. By August 2016 all of the federal district courts which had examined the argument had either expressly rejected it[61] or stated in dicta that the argument is defective.[62] There are a number of excellent reasons why the argument has failed. One of the best is that in *Free Enterprise* the Supreme Court did not establish a bright-line rule that two layers of removal protection are always unconstitutional.[63] 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]."[64] The Court held that two layers were unconstitutional with respect to the PCAOB because its members exercised expansive enforcement,[65] regulatory,[66] and adjudicative authority,[67] and two layers of protection deprived the President of control over the non-adjudicatory

56. *See* Humphrey's Executor v. United States, 295 U.S. 602, 627–32 (1935).

57. 561 U.S. at 492.

58. *See, e.g.*, Duka v. S.E.C., 103 F. Supp. 3d 382, 392 (S.D.N.Y. 2015), *abrogated on other grounds by* Tilton v. S.E.C., 824 F.3d 276 (2d Cir. 2016).

59. *Id.* at 387 ("All ALJs, including SEC ALJs, are removable from employment by their respective agency heads (in this case, the [SEC]) but only for 'good cause.'").

60. Kent Barnett, *Resolving the ALJ Quandry*, 66 VAND. L. REV. 797, 800 (2013). The MSPB is an independent federal agency which handles appeals by federal employees of adverse employment actions. 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]." 5 U.S.C. § 7521 (2012).

61. *See, e.g.*, *Duka*, 103 F. Supp. 3d at 393–96.

62. *See* Gray Fin. Grp. v. S.E.C., No. 1:15-CV-0492-LMM, slip op. at 36 n.10 (N.D. Ga. Aug. 4, 2015), *vacated and remanded on other grounds*, 825 F.3d 1236 (11th Cir. 2016) (expressing "serious doubts" that two-layer removal protection for SEC ALJs is unconstitutional).

63. *See, e.g.*, Free Enterprise Fund v. PCAOB, 561 U.S. 477 536 (Breyer, J., dissenting) ("The Court fails to create a bright-line rule because of considerable uncertainty about the scope of its holding . . . ."); *Duka*, 103 F. Supp. 3d at 393 ("*Free Enterprise* clearly did not establish, as Duka suggests, a categorical rule forbidding 'two levels of "good cause" tenure protection.'").

64. *Free Enterprise*, 561 U.S. at 508.

65. *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.").

66. *Id.* (noting that "the Board may regulate every detail of an accounting firm's practice").

67. *Id.* (noting that "the Board itself can issue severe sanctions in its disciplinary proceedings").

functions.[68] The Court declined to consider the applicability of its holding to other federal employees because none of them were similarly situated to the members of the PCAOB.[69]

Professor Zaring asserts that "it is only through" *Free Enterprise* that SEC APs become problematic.[70] But far from being respondents' most successful parry, the *Free Enterprise* argument has flopped. Conversely, respondents have made a compelling and successful constitutional argument that Professor Zaring does not address. Respondents' best argument that SEC APs are unconstitutional is that SEC ALJs have been appointed in violation of the Appointments Clause of Article II of the United States Constitution.

Unless provided for elsewhere in the Constitution, all officers of the United States are to be appointed in accordance with the Appointments Clause.[71] Officers fall into two categories—principal and inferior. The former—probably those who report directly to the President—must be nominated by the President and confirmed by the Senate.[72] The latter individuals are those whose work is directed and supervised by principal officers or officers of lesser importance.[73] Most "government personnel are neither principal nor inferior officers, but rather 'mere employees' whose appointments are not restricted by the Appointments Clause."[74]

The Appointments 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.[75] 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—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 Office of Personnel Management.[76] In contrast, the first prong of the

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68. *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.").

69. *See id.* at 506–08.

70. Zaring, *supra* note 1, at 1193.

71. Raymond J. Lucia Cos. v. S.E.C., No. 15-1345, 2016 WL 4191191, at *3 (D.C. Cir. Aug. 9, 2016) (citing Buckley v. Valeo, 424 U.S. 1, 132 (1976)).

72. *See* Morrison v. Olson, 487 U.S. 654, 670 (1988) (quoting *Buckley*, 424 U.S. at 132).

73. *See* Edmond v. United States, 520 U.S. 651, 663 (1997) ("[W]e think it evident that 'inferior 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.").

74. Raymond J. Lucia Co., Inc. & Raymond J. Lucia, Sr., SEC Release No. 4190, Release Nos. 31806, 75837, 34-75837, IA-4190, IC-31806, 2015 WL 5172953, at *21 (Sept. 3, 2015), *pet. den.,* No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016).

75. U.S. CONST. art. II, § 2, cl. 2.

76. *See, e.g.*, Hill v. S.E.C., 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015), *vacated and remanded on other grounds*, 825 F.3d 1236 (11th Cir. 2016) (noting concession by SEC that ALJ

argument has been vigorously contested by the SEC, which asserts that its ALJs are mere employees, rather than inferior officers, and therefore the Clause is inapplicable.[77] The SEC is correct that the Appointments Clause does not apply to employees.[78] Nevertheless, for various reasons, the SEC may be fighting a losing battle on the broader issue of whether its ALJs are officers.

The Supreme Court has never articulated a bright-line test for determining who can be properly identified as an inferior officer.[79] In *Buckley v. Valeo*[80] the Court noted that inferior officers "exercis[e] significant authority pursuant to the laws of the United States."[81] In *Morrison v. Olson*[82] the Court applied a functional test based on multiple criteria, including removal by a higher Executive Branch official, limitations on duties, and limited jurisdiction.[83] 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.[84]

SEC ALJs probably are inferior officers, as opposed to mere employees. First, SEC ALJs exercise significant authority. Among other things, they have the power to enforce compliance with discovery orders, and they conduct trials—taking testimony and ruling on the admissibility of evidence.[85] Second, the authority of SEC ALJs is at least equal 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

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in plaintiff Hill's AP "was not appointed by an SEC Commissioner"); Duka v. S.E.C., No. 15 Civ. 357(RMB)(SN), 2015 WL 5547463, at *5 (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.").

77. Raymond J. Lucia Co., Inc. & Raymond J. Lucia, Sr., *supra* note 74, at *2.

78. *See, e.g.*, Freytag v. Comm'r of Internal Revenue, 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.").

79. *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.").

80. 424 U.S. 1 (1976).

81. *See id.* at 126.

82. 487 U.S. 654 (1988).

83. *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).

84. Free Enterprise Fund v. PCAOB, 561 U.S. 477, 510 (2010).

85. Duka v. S.E.C., No. 15 Civ. 357(RMB)(SN), 2015 WL 5547463, at *19 (S.D.N.Y. Sept. 17, 2015) ("SEC ALJs are 'inferior officers' because they exercise 'significant authority pursuant to the laws of the United States.'").

counsel for the Transportation Department are inferior officers."[86] Third, SEC ALJs' "positions are 'established by law,' . . . and 'the duties, salary, and means of appointment . . . are specified by statute.'"[87]

By August 2016 no federal district court had accepted the SEC's position and at least four district court decisions had expressly rejected it, holding that SEC ALJs are inferior officers who were not appointed by any of the prescribed means and therefore their appointments are probably unconstitutional.[88]

However, in August 2016, in *Raymond J. Lucia Cos. v. S.E.C.*,[89] 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.[90] In reaching its decision the D.C. Circuit relied heavily on the logic of its 2000 decision in *Landry v. FDIC*.[91] 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.[92]

According to the *Landry* court, a 1991 Supreme Court case, *Freytag v. Commissioner of Internal Revenue*,[93] 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.[94] *Landry* distinguished *Freytag* on the basis that whereas STJs had such authority, FDIC ALJs did not.[95] There was a concurring opinion in *Landry*, which joined the court's opinion except with regard to petitioner's claim made under the Appointments Clause. The concurrence argued that *Freytag*'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 *Freytag*.[96] According to Professor Kent Barnett, the

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86. Barnett, *supra* note 60, at 812.

87. *Duka*, 2015 WL 5547463, at *4 (quoting Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 881 (1991)).

88. Duka v. S.E.C., 124 F. Supp. 3d 287, 289 (S.D.N.Y. 2015), *vacated and remanded on other grounds*, No. 15-2732, 2015 WL 5547463 (2d Cir. June 13, 2016); Hill v. S.E.C., 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015), *vacated and remanded on other grounds*, 825 F.3d 1236 (11th Cir. 2016); Gray Fin. Grp. v. S.E.C., No. 1:15-CV-0492-LMM, slip op. at 35–36 (N.D. Ga. Aug. 4, 2015), *vacated and remanded on other grounds*, 825 F.3d 1236 (11th Cir. 2016); Timbervest v. S.E.C., No. 1:15-CV-2106-LMM, 2015 WL 7597428, at *12 (N.D. Ga. Aug. 4, 2015).

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

90. *Id.* at *3–7.

91. 204 F.3d 1125 (D.C. Cir. 2000).

92. *Id.* at 1134.

93. 501 U.S. 868 (1991).

94. *Id.* at 882.

95. 204 F.3d at 1133–34.

96. *Id.* at 1142.

concurrence in *Landry* had the better argument,[97] and I agree. The discussion of finality *was* part of an alternative holding.[98]

In *Lucia*, the D.C. Circuit followed *Landry* and applied *Freytag*'s alternative holding to determine the status of SEC ALJs.[99] The *Lucia* court noted that its analysis of *Landry*'s applicability to SEC ALJs began and ended with the ALJs' authority to issue final decisions.[100] Because the initial decisions of SEC ALJs become final only when the SEC issues an order of finality,[101] the D.C. Circuit concluded that the ALJs are mere employees.[102]

I believe *Lucia* was wrongly decided for the same reason that *Landry* was mistaken. Both cases erroneously rely on *Freytag*'s alternative holding. SEC ALJs should be deemed inferior officers for all of the reasons discussed above. And because the SEC freely admits that its ALJs have not been selected by any means set forth in the Appointments Clause,[103] their appointments are unconstitutional. What are the likely consequences if the SEC's current appointments 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.[104] Reappointment of the ALJs by the Commissioners as the head of the department would thus appear to provide a fix,[105] albeit one that carries risk. But to date the SEC has refused to acknowledge either that there is a constitutional problem or that

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97. Barnett, *supra* note 60, at 799, 852.

98. *See* Ironridge Global IV v. S.E.C., Civ. Action No. 1:15-CV-2512-LMM, 2015 WL 7273262, at *15 (N.D. Ga. Nov. 17, 2015) ("Only after it concluded STJs were inferior officers did *Freytag* 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.").

99. *See* Shearman & Sterling LLP, *D.C. Circuit Upholds Constitutionality of SEC Administrative Proceedings* 3 (Aug. 16, 2016), http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/08/DC-Circuit-Upholds-Constitutionality-of-SEC-Administrative-Proceedings-LIT-081616.pdf ("Though the *Lucia* court was careful to note that its decision in *Landry* did not resolve the constitutional status of ALJs for *all* agencies, it nonetheless relied heavily on the logic of that decision.").

100. 2016 WL 4191191, at *4.

101. *Id.* at *5.

102. *Id.* at *3–7.

103. *Id.* at *3 ("The Commission has acknowledged the ALJ was not appointed as the Clause requires. . . .").

104. Free Enterprise Fund v. PCAOB, 561 U.S. 477, 511 (2010).

105. *Hill*, 114 F. Supp. 3d at 1320 ("[T]he ALJ's appointment could easily be cured by having the SEC Commissioners issue an appointment or preside over the matter themselves."); *Securities Litigation Update: Constitutional Challenges to SEC's Administrative Courts Gain Momentum*, DAVIS POLK: CLIENT MEMORANDUM, Sept. 24, 2015, at 2, http://www.davispolk.com/sites/default/files/2015-09-24_Constitutional_Challenges_to_SECs_Administrative_Courts_Gain_Momentum.pdf [https://perma.cc/5B5L-UU2V] ("[T]he SEC may cure the deficiency by having the SEC commissioners ratify the ALJs' appointments.").

reappointment should be the solution.[106]

The SEC's refusal to bend on the issue of whether its ALJs are inferior officers is unsurprising because the ramifications of a concession (or appellate finding) of unconstitutionality may be quite significant, both for the SEC and for other agencies. If the appointment of SEC ALJs is conceded or determined to be unconstitutional, this might call into question the validity of at least all of the open SEC APs.[107] And whereas most ALJs utilized by other federal agencies probably have been appointed by department heads, many—especially those "appointed by agencies that are not departments, such as the Consumer Financial Protection Bureau and FERC"—likely have not been, and thus their appointments also could be unconstitutional.[108]

IV. Fundamental Unfairness

My second major disagreement with Professor Zaring concerns his discussion of what I regard as a false dichotomy between an expectation by respondents and their counsel that APs will be conducted fairly and the orientation by SEC ALJs that procedural regularity trumps equity. I believe SEC APs are fundamentally unfair, as they are currently utilized, but this unfairness is not compelled by the APA. The SEC could choose to substantially reduce procedural unfairness without sacrificing procedural regularity or violating the APA.

SEC APs are fundamentally unfair for multiple reasons. First, there is no reciprocal discovery. As noted, in an AP the SEC effectively conducts its discovery before the OIP is filed, but respondents are denied the right to take discovery of their own.[109] Second, as noted, the AP schedule is greatly compressed.[110] The Enforcement Division often commences an enforcement action after it has spent years investigating the facts and collecting documents, whereas respondents have only a few months after

106. *See* Alison Frankel, *Why the SEC Can't Easily Solve Appointments Clause Problem with ALJs*, REUTERS (June 17, 2015), http://blogs.reuters.com/alison-frankel/2015/06/17/why-the-sec-cant-easily-solve-appointments-clause-problem-with-aljs/ [https://perma.cc/L6NG-CWQK] (noting that SEC has avoided addressing potential consequences of proposed quick fix).

107. *See generally* 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 2015), http://www.postschell.com/site/files/post__schell__bloomberg_bna__sec_alj_constitutional_questions__6_19_15.pdf [https://perma.cc/WNS2-PX9U] (discussing possible effects of finding appointments of SEC ALJs unconstitutional).

108. *See* Kent Barnett, *The SEC's Inferiority Complex*, YALE J. REG.: NOTICE & COMMENT (June 11, 2015), http://www.yalejreg.com/blog/the-secs-inferiority-complex-by-kent-barnett [https://perma.cc/N4CX-MFNL].

109. *See supra* notes 29–35 and accompanying text.

110. *See supra* note 28 and accompanying text.

the OIP is filed to review potentially millions of pages of documents.[111] Under the commonly used 300-day timeline, the hearing must be scheduled for a date approximately four months from service of the OIP.[112] Extensions may be granted, but the SEC has adopted a policy that strongly disfavors extensions, postponements, or adjournments.[113]

Third, SEC APs entail a combination of functions. The SEC Commissioners authorize all enforcement actions and subsequently act as the first level of appeal. I agree with Professor Zaring that this combination is constitutional. But this does not mean it is fair or presents an appearance of fairness. When the SEC proceeds with an enforcement action this "reflect[s] a substantive judgment about the strength and merit of a case."[114] If the Commissioners ultimately side with the Enforcement Division on appeal, they may "not have done so with the disinterestedness required for credibility and legitimacy."[115] Many respondents in SEC APs believe they do not receive fair hearings or appeals to the Commissioners,[116] and this unfairness may manifest in the SEC's dominant record of home court success. In this context the perception of bias or unfairness may be almost as important as the presence of bias.[117]

Professor Zaring suggests that equity in SEC APs is inconsistent with procedural regularity and the latter should trump under the APA.[118] In support of this suggestion he argues that federal appellate courts reviewing decisions by the SEC Commissioners are deferential, employ a "substantial

111. *See* 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., Jan. 2015, at 1 ("While the staff has often taken years, the defendants seldom have more than months to prepare.").

112. *See supra* note 28 and accompanying text.

113. 17 C.F.R. § 201.161(b)(1) (2015) (addressing extensions of time, postponements, and adjournments).

114. 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/3/#2446996b3262 [https://perma.cc/S2Y9-B93H].

115. *Id.*

116. *See, e.g.*, Cox, *supra* note 18, at 7 ("At a minimum, it *appears* to [respondents] and to the outside world that the process is much less fair.") (emphasis added).

117. *See, e.g.*, Am. Bar Ass'n Comm. on Fed. Regulation of Sec., *Report of Task Force on the SEC Administrative Law Judge Process*, 47 BUS. LAWYER 1731, 1734 (1992) ("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."); Peter J. Henning, *New Criticism Over the S.E.C.'s Use of In-House Judges*, N.Y. TIMES (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 [https://perma.cc/9YGH-4758] ("[T]his battle is more about the perception that the administrative process is flawed, not whether there is actually a significant home court advantage.").

118. Zaring, *supra* note 1, at 1215–16.

evidence" standard,[119] and are unconcerned about fairness or equity.[120] He is correct about deference and the standard of review with respect to factual determinations.[121] But it is precisely because federal appellate review is deferential that we should be concerned about procedural unfairness at the hearing level. A federal appellate court will defer to the SEC and affirm its affirmance of an ALJ's initial decision so long as it is supported by substantial evidence, even if the hearing was unfair. And 95% of the time the Commissioners do affirm ALJ initial decisions.[122]

Moreover, I see no inherent conflict between procedural fairness and regularity in SEC APs. The SEC could choose to revamp its RoP to make them more equitable, without violating the APA, and it has already taken modest steps in that direction. In September 2015, the SEC announced that it had voted to propose amendments to its RoP.[123] This announcement was an implicit acknowledgement that the current RoP are unfair and outdated.[124] In July 2016 the SEC adopted amendments to the RoP that to some extent reflect comments received by the agency in response to its initial proposals. The new amendments became effective on September 27, 2016 and apply to all APs initiated on or after that date.[125] The amendments are a first step in the right direction, but they fail to cure what ails the current administrative process. The SEC should further revise its RoP in the following respects.

First, the RoP should be amended to permit additional depositions. Prior to the 2016 amendments the SEC permitted depositions only to preserve the testimony of witnesses unlikely to be available for hearing.[126] Expanding the scope of permissible depositions to permit respondents in SEC APs to cross-examine the agency's witnesses prior to trial could accomplish multiple goals—respondents could better assess the merits of

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119. *Id.* at 1168.

120. *Id.* at 1215–16.

121. The Commission's conclusions of law may be set aside only if they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." Rapoport v. S.E.C., 682 F.3d 98, 103 (D.C. Cir. 2012); KPMG, LLP v. S.E.C., 289 F.3d 109, 121 (D.C. Cir. 2002) (quotations omitted).

122. *See* Eaglesham, *supra* note 10.

123. *See* Press Release, U.S. Securities and Exchange Commission, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015), http://www.sec.gov/news/pressrelease/2015-209.html [https://perma.cc/CS94-RASR].

124. *See* Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAWYER 1, 40 (Winter 2015–2016) ("The SEC's proposals suggest that the agency has, at long last, come to the recognition that it has overreached.").

125. Margaret A. Dale & Mark D. Harris, *SEC Adopts Amendments to Rules for Administrative Proceedings*, N.Y. L.J. (Aug. 10, 2016), http://www.proskauer.com/files/News/c4d0e098-0611-4a25-bc63-50e9367330c7/Presentation/NewsAttachment/3f3d1bb7-1d1c-4893-a477-54c5c3008f75/070081616%20Proskauer.pdf [https://perma.cc/THW3-NK62].

126. 17 C.F.R. § 201.234, 201.233(a) (2015).

the SEC's case, both sides could better evaluate settlement prospects, and respondents could better formulate their own trial strategy.

The SEC's September 2015 announcement included a proposed amendment to Rule 233 of the RoP which provided that in matters with one respondent each side may depose a maximum of three persons and in matters where there are multiple respondents each side may depose up to five persons.[127] The Enforcement Division is one side and the group of all respondents is the other side. Each "deposition is limited to one day of 6 hours, including cross-examination."[128]

The SEC's proposed rule was too restrictive in several respects. The proposed rule did not contemplate that SEC investigative personnel could be deposed, or that SEC files previously not subject to discovery could be discoverable. Moreover, the limit of three depositions in single respondent cases and five depositions in multiple respondent cases was much too low, especially in complex cases.[129] Finally, giving the Enforcement Division and respondents an equal number of deposition slots will do little or nothing to even the playing field, because prior to the filing of the OIP the Division staff most likely will have already taken dozens of examinations under oath.[130]

The SEC's final amendment is not much better than the agency's original proposal. The maximum length of each deposition was extended by one hour, and each side can seek leave from the ALJ to take two additional depositions upon a showing of compelling need.[131] The final

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127. Amendments to the Commission's Rules of Practice, 80 Fed. Reg. 60,091, 60,102 (proposed Oct. 5, 2015) (to be codified at 17 C.F.R. pt. 201).

128. *Id.* at 60,103.

129. *See, e.g.*, Peter J. Henning, *A Small Step in Changing S.E.C. Administrative Proceedings*, N.Y. TIMES (Sept. 28, 2015), http://www.nytimes.com/2015/09/29/business/dealbook/a-small-step-in-changing-sec-administrative-proceedings.html?_r=0 [https://perma.cc/SP4D-KW8B] ("[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."); *SEC Moves in the Right Direction with Proposed Amendments to Rules Governing Administrative Proceedings, but the Changes Do Not Go Far Enough*, CLIENT ALERT (Gibson Dunn), Sept. 28, 2015 [hereinafter *SEC Moves in the Right Direction*], http://www.gibsondunn.com/publications/pages/SEC-Proposed-Amendments-to-Rules-Governing-Administrative-Proceedings.aspx [https://perma.cc/2AYM-G74B] ("[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. This is particularly true in proceedings against multiple respondents, who may have widely divergent interests and significant differences of opinion as to which witnesses should be deposed.").

130. *See* Peter K.M. Chan et al., *Tweaking the 'Home Court' Rules for SEC Administrative Proceedings*, LAWFLASH (Morgan Lewis), Sept. 28, 2015, http://www.morganlewis.com/pubs/tweaking-the-home-court-rules-for-sec-administrative-proceedings [https://perma.cc/2ZQ9-F7QR] ("The effect will be to leave the playing field tilted in favor of the Division.").

131. *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 [https://perma.cc/BVE5-HRSC].

amendment is defective for the same reasons that undercut the original proposal. At a minimum, Rule 233 should be modified to significantly increase the capped number of deposition slots, or to grant SEC ALJs the discretion to consider the complexity of a proceeding in determining the appropriate number of depositions.[132]

Second, the rigid timelines utilized by the SEC should be relaxed. As noted, before the RoP were amended in 2016, most SEC APs proceeded under the 300-day timeline, which provided for hearings to occur 120 days from filing of the OIP.[133] This timeline, and the alternatives, were adopted in 2003, prior to the dramatic expansion under Dodd-Frank of the SEC's administrative enforcement authority. This framework is anachronistic and should be restructured to reflect both the sea-change wrought by Dodd-Frank and the modern explosion of electronically stored information.

The SEC's September 2015 announcement included a proposed amendment to Rule 360 that would expand the foregoing timeline, but not by much.[134] For example, proposed amended Rule 360 would permit an administrative hearing in the most common situation to be scheduled up to eight months following the service of the OIP, thereby doubling the current deadline of four months.[135] This expansion was helpful but insufficient to reduce the advantage currently enjoyed by the SEC.[136] In the final amended rule the SEC extended the timeline in the most common situation up to a maximum of ten months.[137] This remains inadequate. At a minimum, Rule 360 should be further amended to permit either longer or more flexible time periods. Rule 16 of the Federal Rules of Civil Procedure vests federal district judges with discretion to issue scheduling orders that reflect the complexity of cases and the scheduling needs of the parties.[138] Rule 360 of the RoP should include an analogous provision.

Third, the RoP should be further amended to exclude hearsay evidence. Pursuant to the July 2016 amendments, Rule 320 was amended to clarify that hearsay evidence is admissible in SEC APs, if it is relevant,

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132. *See The SEC's Proposed Modernization of its Rules for Administrative Proceedings*, COVINGTON & BURLING LLP, Sept. 28, 2015, at 2, https://www.cov.com/~/media/files/corporate/publications/2015/09/the_secs_proposed_modernization_of_its_rules_for_administrative_proceedings.pdf [https://perma.cc/K4KP-V7YN] ("[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.").

133. *See supra* notes 27–28 and accompanying text.

134. Amendments to the Commission's Rules of Practice, 80 Fed. Reg. at 60,104–60,105.

135. *Id.*

136. *See SEC Moves in the Right Direction*, *supra* note 129 ("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.").

137. *See* Ward, Daniels & Perrin, *supra* note 131.

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

material, and reliable—in contrast to the Federal Rules of Evidence, which exclude hearsay.[139]

One analysis concluded: "While the amended Rules of Practice provide a few incremental changes that appear to improve the fairness of the SEC's administrative proceedings, they do not fundamentally alter the balance of power."[140] I agree.

V. Conclusion

The expanded use of APs by the SEC has become one of the most controversial topics in securities enforcement. Professor Zaring makes a valuable contribution to our understanding of APs, but I disagree with his doctrinal analysis in two key respects. First, his discussion of the constitutionality of the proceedings fails to acknowledge the best argument presented by respondents. It is not that SEC ALJs enjoy two levels of removal protection. Even if they do, such protection is not unconstitutional. The most compelling argument is that SEC ALJs probably are inferior officers who have been appointed in violation of the Appointments Clause. Second, Professor Zaring suggests that there is a chasm that cannot be crossed between the expectation by respondents and their counsel that APs will be conducted fairly and the orientation by SEC ALJs that procedural regularity trumps equity. I think this is a false dichotomy. The SEC could revamp its RoP to improve the fairness of APs without violating the APA in any respect. The SEC has acknowledged that its RoP need to change and it has taken a step in the right direction by adopting certain amendments, but that step is insufficient.

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139. *See* Ward, Daniels & Perrin, *supra* note 131.

140. Cadwalader, Wickersham & Taft LLP, Clients & Friends Memo, *The SEC Retains its House Advantage During Administrative Proceedings* 4 (Aug. 5, 2016), http://www.cadwalader.com/uploads/cfmemos/c355365b803d0866cd353569cf77b087.pdf [https://perma.cc/N6LD-JE35].