

# Enforcement Discretion at the SEC

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

*This Article evaluates the SEC's new ALJ policy both qualitatively and quantitatively, offering an in-depth perspective on how formal adjudication—the term for the sort of adjudication over which ALJs preside—works today. It argues that the suits challenging the SEC's administrative proceedings are without merit; agencies have almost absolute discretion as to whom and how they prosecute, and administrative proceedings, which have a long history, do not threaten the Constitution. The controversy illuminates instead dueling traditions in the increasingly intertwined doctrines of corporate and administrative law: the corporate bar expects its judges to do equity; agencies and their adjudicators are more inclined to privilege procedural regularity.*

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[T]he SEC always seems to win before its in-house judges.<sup>1</sup>

## Introduction

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

Gupta was just the first high-profile defendant to get this treatment. In 2015, the SEC filed a complaint against Lynn Tilton, Wall Street's "turnaround queen" and the owner of over seventy companies,<sup>5</sup> alleging that she had defrauded investors of \$200 million.<sup>6</sup> The agency asked one of its in-house judges to decide the case.<sup>7</sup> Wing Chau, one of the antagonists of *The Big Short*, Michael Lewis's bestselling book on the financial crisis,

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

2. Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL STREET J. (Oct. 21, 2014, 9:40 AM), <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> [<https://perma.cc/G7GQ-DBJC>] (“[T]he [SEC] has . . . suffered some high-profile courtroom setbacks in the past year.”).

3. Rajat K. Gupta, Order Instituting Public Administrative and Cease-and-Desist Proceedings, Securities Act Release No. 9192, Exchange Act Release No. 63,995, Investment Advisers Act Release No. 3167, Investment Company Act Release No. 29,590, 100 SEC Docket 1755, 1755 (ALJ Mar. 1, 2011).

4. Gupta was part of a conspiracy organized by principals of the Galleon Hedge Fund. As one judge put it, “[o]n March 1, 2011, the Securities and Exchange Commission . . . —having previously filed all of its Galleon-related insider trading actions in this federal district—decided it preferred its home turf.” *Gupta v. SEC*, 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011).

5. Robert Frank, *Tilton Flaunts Her Style at Patriarch*, WALL STREET J. (Jan. 8, 2011, 12:01 AM), <http://www.wsj.com/articles/SB10001424052748704055204576068253540689070> [<https://perma.cc/QH4K-GPXE>]; Tiffany Kay & Phil Milford, ‘Turnaround Queen’ Tilton’s Fight with MBIA Goes On, BLOOMBERG (Jan. 6, 2016, 12:46 PM), <http://www.bloomberg.com/news/articles/2016-01-06/zohar-judge-continues-bankruptcy-case-wants-evidence-hearing> [<https://perma.cc/34DU-BL7D>].

6. Lynn Tilton, Order Instituting Public Administrative and Cease-and-Desist Proceedings, Investment Advisers Act Release No. 4053, Investment Company Act Release No. 31,539, 2015 WL 1414546 (ALJ Mar. 30, 2015).

7. Tilton argued that this judge—in her view an employee of the SEC who reports to the very commissioners who decided to file suit against her—was “outside the chain of command of the United States.” Pete Brush, *Tilton Scraps with SEC over Commission Judge’s Authority*, LAW360 (May 11, 2015, 6:14 PM), <http://www.law360.com/articles/654570/tilton-scraps-with-sec-over-commission-judge-s-authority> [<https://perma.cc/TYG2-ELKV>]. Her lawyers argued that “[t]he SEC’s administrative machinery does not provide a reasonable mechanism,” with the agency acting as both judge and prosecutor in Tilton’s case, to protect her rights. Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 4, *Tilton v. SEC*, Fed. Sec. L. Rep. (CCH) 98,560 (S.D.N.Y. 2015) (No. 15-CV-02472), 2015 WL 1501674.

also found his case before an ALJ.<sup>8</sup> The Computer Sciences Corporation agreed to pay a \$190 million fine in a case that never saw the inside of a federal courtroom; the Commission settled that case as an administrative proceeding.<sup>9</sup>

These defendants have joined many others who, when they found out where their case was going to be heard, filed suit against the agency for unconstitutionally depriving them of their right to a day in court.<sup>10</sup> They have argued that defendants cannot win before SEC ALJs, a complaint that has been echoed by columnists in the *New York Times*,<sup>11</sup> editorialists in the *Wall Street Journal*,<sup>12</sup> a white paper issued by the Chamber of Commerce,<sup>13</sup>

8. Richard F. Albert, *Duka v. SEC Redux - SEC Holds Home Court Advantage for Another Round*, FORBES (Apr. 23, 2015, 9:59 AM), <http://www.forbes.com/sites/insider/2015/04/23/duka-sec-redux-sec-holds-home-court-advantage-for-another-round/> [<https://perma.cc/44HH-KCDR>].

9. Nicholas S. Goldin & Yafit Cohn, *SEC Charges Computer Sciences Corporation & Former Executives with Accounting Fraud*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 23, 2015), <http://corpgov.law.harvard.edu/2015/07/23/sec-charges-computer-sciences-corporation-former-executives-with-accounting-fraud/> [<https://perma.cc/FX2N-TBTV>] (“[T]he [SEC] entered into settled administrative cease-and-desist proceedings with Computer Sciences Corporation (‘CSC’) and some of its former executives due to the company’s alleged manipulation of financial results and concealment of problems with the company’s largest contract.”).

10. *See, e.g.*, *Duka v. SEC*, 124 F. Supp. 3d 287, 287 (S.D.N.Y. 2015) (granting preliminary injunction on an Appointments Clause challenge to ALJ mechanism); *Chau v. SEC*, 72 F. Supp. 3d 417, 431, 434–37 (S.D.N.Y. 2014) (dismissing due process and equal protection “class of one” challenges to ALJ mechanism for lack of subject matter jurisdiction); *Jarkesy v. SEC*, 48 F. Supp. 3d 32, 40 (D.D.C. 2014) (dismissing a due process challenge to ALJ mechanism for lack of subject matter jurisdiction); *Gupta v. SEC*, 796 F. Supp. 2d 503, 513–14 (S.D.N.Y. 2011) (allowing an equal protection “class of one” challenge to ALJ mechanism to proceed). Other challenges are still underway in the federal courts. *See, e.g.*, Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial, *supra* note 7, at 1–3 (alleging separation of powers and Appointments Clause violations); Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 1–2, *Gray Fin. Grp., Inc. v. SEC*, No. 1:15-CV-00492, 2015 WL 9597482 (N.D. Ga. Feb. 19, 2015) [hereinafter *Gray Financial Complaint*] (alleging violation of the Appointments Clause in double for-cause protection of SEC ALJs); Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 1–2, *Stilwell v. SEC*, No. 14-CV-7931, 2014 WL 5100665 (S.D.N.Y. Oct. 1, 2014) (alleging due process violations and violation of the Appointments Clause). The Computer Sciences Corporation settled its case. *Golden & Yafit, supra* note 9.

11. Gretchen Morgenson, *Crying Foul on Plans to Expand the S.E.C.’s In-House Court System*, N.Y. TIMES (June 26, 2015), [http://www.nytimes.com/2015/06/28/business/secs-in-house-justice-raises-questions.html?\\_r=0](http://www.nytimes.com/2015/06/28/business/secs-in-house-justice-raises-questions.html?_r=0) [<https://perma.cc/8VKM-3QGH>] (“[I]s it right for defendants to be investigated, prosecuted and judged by officials of the same agency?”).

12. Russell G. Ryan, *The SEC as Prosecutor and Judge*, WALL STREET J. (Aug. 4, 2014, 7:36 PM), <http://www.wsj.com/articles/russell-g-ryan-the-sec-as-prosecutor-and-judge-1407195362> [<https://perma.cc/P8HL-UGL4>] (“[A] surge in administrative prosecutions should alarm anyone who values jury trials, due process and the constitutional separation of powers.”).

13. U.S. CHAMBER OF COMMERCE, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES 14 (2015), <https://securitiesdiary.files.wordpress.com/2014/11/chamber-of-commerce-report-on-reforms-needed-in-sec-enforcement-process.pdf> [<https://perma.cc/XT4X-8C8M>] (“Throughout its modern history, there has been criticism of the Commission’s use of administrative proceedings to create regulatory policy . . .”). Along the same lines, an American Bar

and even, politely, by one of the SEC's own commissioners.<sup>14</sup> The agency's inspector general has conducted an investigation into whether the ALJs are biased.<sup>15</sup> One federal judge has said that these arguments are "compelling and meritorious."<sup>16</sup> Other judges have agreed.<sup>17</sup>

The SEC has vigorously—and, this Article argues, correctly—defended its power to choose where it sues. Agencies have always enjoyed unfettered discretion to choose their enforcement targets and their policymaking fora.<sup>18</sup> Formal adjudication under the Administrative Procedure Act (APA), which is the process that SEC ALJs offer, has been with us for decades and has never before been thought to be unconstitutional in any way.<sup>19</sup> It violates no rights, nor offends the separation of powers; if anything, scholars have bemoaned the fact that it

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Association task force studied sixty-two SEC administrative cases over a five-year period and found that ALJs upheld the SEC in fifty-eight of the cases. See Bureau of National Affairs, *ABA Task Force Survey Finds ALJs Almost Always Uphold SEC Charges*, 21 SEC. REG. & L. REP. 1531, 1531 (1989) (providing the results of an ABA task force survey finding "that ALJs upheld the charges in SEC administrative proceedings in 58 of 62 cases, covering a span of five years"); Coffee, *supra* note 1, at 1887–88, 1890 (making a similar claim about SEC ALJs at the very beginning of their roles in enforcement proceedings).

14. Michael S. Piowar, SEC Comm'r, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly, and Efficient SEC (Feb. 20, 2015), <http://www.sec.gov/news/speech/022015-speechmsp.html> [<https://perma.cc/UG97-8J9W>] (addressing the need to "avoid the perception that the Commission is taking its tougher cases to its in-house judges" and to "ensure that all are treated fairly and equally").

15. However, the SEC's inspector general did not "develop[] any evidence to support the allegations of bias in ALJs' decisions in the Commission's administrative proceedings." OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, INTERIM REPORT OF INVESTIGATION CASE# 15-ALJ-0482-I, at 4 (2015), <https://www.sec.gov/oig/reportspubs/oig-sec-interim-report-investigation-admin-law-judges.pdf> [<https://perma.cc/GY4G-V4K3>].

16. *Bebo v. SEC*, Fed. Sec. L. Rep. (CCH) ¶ 98,385, at 94,133, 94,134 (E.D. Wis. 2015).

17. See, e.g., *Hill v. SEC*, 114 F. Supp. 3d 1297, 1307 (N.D. Ga. 2015) (finding that "requiring Plaintiff to pursue his constitutional claims following the SEC's administrative process 'could foreclose all meaningful judicial review' of his constitutional claims") (quoting *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 489 (2010)); *Bob Van Voris & Patricia Hurtado, SEC Loses Second Round in Battle Over In-House Judges*, BLOOMBERG (Aug. 12, 2015, 10:18 AM), <http://www.bloomberg.com/news/articles/2015-08-12/u-s-judge-blocks-sec-case-against-ex-s-p-executive-duka> [<https://perma.cc/GG6B-BRNC>] (discussing two cases where the SEC lost challenges regarding the use of in-house judges).

18. See *Heckler v. Chaney*, 470 U.S. 821, 837–38 (1985) (concluding that agency enforcement decisions are not subject to review under the APA); *SEC v. Chenery Corp.*, 332 U.S. 194, 202–03 (1947) (deciding that agencies have discretion to choose between prospective rulemaking and retrospective adjudication).

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

offers an inefficiently large amount of process to defendants, administered by insulated civil servants who in no way threaten the President's control over the Executive Branch.<sup>20</sup>

The most interesting questions posed by the SEC's new policy are not doctrinal; they are empirical and cultural.<sup>21</sup> An agency's turn to formal adjudication is a rare thing these days;<sup>22</sup> it warrants an investigation of how this grand, old, but increasingly disregarded institution works in its reinvigorated form at the SEC. This Article shows that defendants can rarely escape liability before ALJs, but can reduce their damages relative to the amount sought by the agency's enforcement division. It also documents the routine nature of much of what ALJs do: defaulting defendants who fail to respond to complaints, imposing sanctions on brokers and investment advisors who have already been adjudged to commit securities fraud in federal court, and so on. Adding high-profile insider trading and other cases of first impression to this mix is different from the ordinary sort of work that ALJs have been expected to do.

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

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

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20. See, e.g., JERRY L. MASHAW, BUREAUCRATIC JUSTICE: MANAGING SOCIAL SECURITY DISABILITY CLAIMS 116–17 (1983) (praising efforts to streamline evidentiary problems with disability claims “[f]rom the perspective of an administration concerned with systemic rationality”); Richard J. Pierce, Jr., *Political Control Versus Impermissible Bias in Agency Decisionmaking: Lessons from Chevron and Mistretta*, 57 U. CHI. L. REV. 481, 504–07 (1990) (suggesting that courts protect ALJ independence at a cost of efficiency and that they should permit agencies to “discipline inefficient ALJs”).

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

22. Jeffrey S. Lubbers, *APA-Adjudication: Is the Quest for Uniformity Faltering?*, 10 ADMIN. L.J. AM. U. 65, 79 (1996) (noting the “decline in agency use of administrative law judges to conduct formal adjudications”).

23. “Delaware corporate law may well be seen as an extended commentary on the concepts of legality and equity. . . . [I]n Delaware, equity trumps.” Rodman Ward, Jr. & Paul J. Lockwood, *Corporate Law*, in DELAWARE SUPREME COURT: GOLDEN ANNIVERSARY 1951-2001, at 92 (Randy J. Holland & Helen L. Winslow eds., 2001). For a very well-known discussion, see Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997) (“Delaware courts generate in the first instance the legal standards of conduct (which influence the development of the social norms of directors, officers, and lawyers) largely through what can best be thought of as ‘corporate law sermons.’ These richly detailed and judgmental factual recitations, combined with explicitly judgmental conclusions, sometimes

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

But federal agencies and the ALJs who work for them, unlike the Delaware or federal courts, make their decisions about policy constrained by procedure rather than fairness. ALJs cannot make sweeping equitable rulings against their agencies and would likely be quickly reversed on appeal to the commissioners for whom they work if they harshly castigated agency policy.<sup>25</sup> They are generally uninterested in the fuzzy, equitable mores of the chancery and more focused on the requirements of the APA, as interpreted by the D.C. Circuit and the Supreme Court. This procedure-based orientation is different from the equity-based hopes that the corporate bar places in the judges who would hear their cases.<sup>26</sup>

It is, moreover, worth getting to the bottom of the difference. How administrative adjudicators are supposed to approach their work is, or at least was, one of the central questions of administrative law. The American administrative state was founded on adjudication by agency officials. The first federal agencies were little more than specialized courts; the Interstate Commerce Commission, founded in 1887, scrutinized the rates set by railroads to see whether they were “unjust and unreasonable” on a case-by-case basis.<sup>27</sup> The Federal Trade Commission, founded in 1914, broke up

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impose legal sanctions but surprisingly often do not.”); *see also* William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery—1792-1992*, 18 DEL. J. CORP. L. 819, 821–22 (1993) (“Equity is the flexible application of broad moral principles (maxims) to fact specific situations for the sake of justice. Delaware has preserved the essence.”).

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

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

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

27. *See* Asimow, *supra* note 19, at 159 (“The ICC did its business through case-by-case adjudication involving specific rate disputes between shippers and carriers.”); Paul Stephen Dempsey, *The Rise and Fall of the Interstate Commerce Commission: The Tortuous Path from Regulation to Deregulation of America’s Infrastructure*, 95 MARQ. L. REV. 1151, 1160–61 (2012) (recounting the creation of the ICC as the country’s first independent administrative agency and its initial mandate to regulate the interstate rates charged by railroads and ensure that they were just and reasonable). In 1917, Adolph Berle described the Interstate Commerce Commission’s (ICC’s) work as essentially judicial. A. A. Berle, Jr., *The Expansion of American Administrative Law*, 30 HARV. L. REV. 430, 442 (1917) (“[I]t was said that the functions it exercised were ‘quasi-

trusts similarly on a trust-by-trust basis.<sup>28</sup> These agencies were expected to make most of their policy decisions through hearings at which counsel would appear on behalf of both the agency and regulated industry and evidence would be presented in a trial-type atmosphere.<sup>29</sup>

But the adjudicative model has fallen into disfavor. Modern agencies such as the Environmental Protection Agency do almost all of their important work through lengthy and complicated rulemakings.<sup>30</sup> The House of Representatives in March 2016 passed a bill that would prevent the Federal Trade Commission from using administrative adjudications in antitrust actions.<sup>31</sup> The federal government now employs about 1,700 administrative law judges, but the vast majority of those judges work for the Social Security Administration hearing appeals of revocations of determinations of disability.<sup>32</sup> The D.C. Circuit in 1970 waxed rhapsodic about the Federal Trade Commission's decision to abandon its trial model of policymaking when it issued its octane labelling rule, observing that "courts are recognizing that use of rule-making to make innovations in agency policy may actually be fairer to regulated parties than total reliance on case-by-case adjudication."<sup>33</sup>

If the SEC is planning to return to administrative adjudication as a substitute to enforcement through the courts and as an important instrument for setting policy, then it will be reinvigorating formal adjudications, at least in one agency. To be sure, the data suggest that the picture is at least

judicial'; and the present method of stating the result is that the [ICC] has full authority to inquire into judicial matters." (footnote omitted).

28. See Lesley Fair, *FTC Milestones: Shared Beginnings in the Circle Cilk Case*, FED. TRADE COMMISSION: COMPETITION MATTERS (Nov. 6, 2014, 2:05 PM), <https://www.ftc.gov/news-events/blogs/competition-matters/2014/11/ftc-milestones-shared-beginnings-circle-cilk-case> [<https://perma.cc/L8EQ-X5HK>] ("The FTC's founding is often associated with turn-of-the-century trust busting . . .").

29. See Asimow, *supra* note 19, at 159 (observing that "[t]he ICC did its business through case-by-case adjudication" that needed to observe due process requirements and that the ICC served as a model for other administrative agencies).

30. See Richard J. Pierce, Jr., *Rulemaking and the Administrative Procedure Act*, 32 TULSA L.J. 185, 188-90 (1996) (discussing the importance of rulemaking, the historical trends favoring more administrative rule creation, and the extensive use of rules by modern agencies like the EPA).

31. Standard Merger and Acquisition Reviews Through Equal Rules Act of 2015, H.R. 2745, 114th Cong. (as passed by the House of Representatives, Mar. 23, 2016).

32. See VANESSA K. BURROWS, CONG. RESEARCH SERV., ADMINISTRATIVE LAW JUDGES: AN OVERVIEW 2 (2010) ("[T]he agency that hires by far the most number of ALJs is the Social Security Administration . . ."); Bernard Schwartz, *Adjudication and the Administrative Procedure Act*, 32 TULSA L.J. 203, 209, 213 (1996) (reviewing the agency assignments of the then 1,343 ALJs accredited by the federal government and discussing social security disability cases); Jean Eaglesham, *U.S. Chamber of Commerce Criticizes SEC's In-House Court*, WALL STREET J. (July 15, 2015, 12:01 AM), <http://www.wsj.com/articles/u-s-chamber-of-commerce-criticizes-secs-in-house-court-1436932861> [<https://perma.cc/H7AR-5QQ4>] (putting the number of federal ALJs at "nearly-1,700").

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

somewhat murky, as the agency has not stopped filing federal lawsuits and ALJ work is increasing, but not exponentially.<sup>34</sup> But if ALJs continue to perform as administrative proceduralists, rather than doers of equity, then the corporate bar will have to get used to a different sort of approach from the tribunals before which they appear. As they grow used to the constraints and methods of ALJs, they may grow to appreciate the consistency offered by administrative law.

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

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

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

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

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

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34. See *infra* subpart I(D).

### A. ALJ Jurisdiction

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

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

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

The statute created the modern regime of administrative proceedings by giving the Enforcement Division the right to bring cases against these regulated defendants administratively, rather than in federal court. These jurisdictional rights were awarded by increasing the remedies available through these proceedings. ALJs were given the power to order disgorgement of ill-gotten gains and issue fines, but much of the threat of administrative proceedings lay in the injunctive powers enjoyed by the adjudicators. The Penny Stock Reform Act awarded the ALJs cease-and-desist powers—that is, powers prohibiting licensed firms and persons from

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

36. Though it is under some constraints—it must go to court to obtain certain remedies that may only be awarded by judges. *See infra* subpart I(C).

37. *How Investigations Work*, *supra* note 35.

38. As Bob Van Voris and Matt Robinson put it, “[t]he regulator began holding administrative hearings shortly after its creation in 1934. The Dodd-Frank law, enacted in 2010, expanded the agency’s jurisdiction beyond brokers and investment advisers and empowered its judges to issue orders and levy fines that previously had been available only in federal court.” Bob Van Voris & Matt Robinson, *For the SEC’s In-House Court, a Question of Justice for All*, BLOOMBERG (Aug. 10, 2015, 10:20 AM), <http://www.bloomberg.com/news/articles/2015-08-10/for-the-sec-s-in-house-court-a-question-of-justice-for-all> [<https://perma.cc/3EBJ-JYM8>].

39. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, § 102, 104 Stat. 931, 933 (1990) (codified at 15 U.S.C. § 77h-1 (2012)).

violating the securities laws, and the ability to bar, or revoke the license of, defendants from doing securities-industry work.<sup>40</sup>

This threat to the livelihood of practitioners made agency adjudicators important to a new class of potential defendants, but it left the federal courts with exclusive jurisdiction over cases where the securities laws were violated but the defendants were not licensed to practice before the Commission.<sup>41</sup> These included most insider-trading claims, securities fraud claims, and claims about unregistered securities—the sorts of cases most likely to generate headlines.<sup>42</sup>

Dodd-Frank expanded the agency’s administrative jurisdiction to anyone alleged to have violated the securities laws, rather than only those registered with the agency, essentially by permitting the agency to pursue any remedy against unregistered defendants that it could pursue against registered defendants.<sup>43</sup>

### B. Process

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

But while *nemo iudex in sua causa*—no man should be judge in his own case—is one of the most traditional, or at least Latinate, of the propositions of Anglo-American law, agencies have always conducted a variety of adjudications; when ALJs are involved, these proceedings look

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40. *Id.* § 203, 104 Stat. at 939.

41. *Id.* § 203(c)(2), 104 Stat. at 940 (“This subsection shall apply only to a respondent that acts, or, at the time of the alleged misconduct acted, as a broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, or transfer agent . . .”).

42. See David A. Wilson, *Coming to an Administrative Law Judge Near You: Insider-Trading Cases*, WESTLAW J. SEC. LITIG. & REG., Dec. 11, 2014, at 1, 1 (explaining that insider trading cases are often “high-profile” and that in a typical insider trading case no parties are regulated entities, so prior to Dodd-Frank, cases could be brought only in federal court).

43. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929p, 124 Stat. 1376, 1862–65 (2010) (codified in scattered sections of 15 U.S.C.). The statute broadened the SEC’s authority to impose industry-wide suspensions, which prohibit securities professionals who are found to have violated any aspect of securities laws from joining any regulated entity, including brokers, dealers, investment advisors, participants in the municipal securities markets, transfer agents, and rating agencies. *Id.* As Andrew Ceresney, the director of the SEC Enforcement Division explained, “Congress provided us authority to obtain penalties in administrative proceedings against unregistered parties comparable to those we already could obtain from registered persons.” Andrew Ceresney, Dir., SEC Div. of Enf’t, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297> [<https://perma.cc/RF52-6ZLA>].

44. SEC Rules of Practice, 17 C.F.R. § 201 (2015).

adversarial and lawyerly.<sup>45</sup> The SEC's rules and the APA provide for a trial experience that is analogous to that which would occur before a federal judge.<sup>46</sup>

The court-like nature of so-called formal (that is, APA) administrative adjudication is an analogy frequently made by the Supreme Court.<sup>47</sup> ALJs oversee adversarial proceedings, rule on evidentiary questions, regulate the course of the hearing, and make decisions.<sup>48</sup> They have the authority to administer oaths and affirmations to witnesses and oversee the taking of evidence, ruling on questions of admissibility and accepting offers of proof.<sup>49</sup> ALJs also have the full subpoena power of the agency itself and may issue subpoenas to third parties in some circumstances.<sup>50</sup>

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

The ALJ serves as the finder of fact and of law; there is no jury. The Federal Rules of Civil Procedure and the Federal Rules of Evidence do not apply; instead the proceedings are governed by the SEC's own Rules of

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45. See Adrian Vermuele, *Contra Nemo Iudex in Sua Causa: The Limits of Impartiality*, 122 YALE L.J. 384, 386–87, 399 (2012) (discussing some of the intricacies of the proposition in the context of administrative adjudication); *Office of Administrative Law Judges*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/alj> [<https://perma.cc/4FTF-S79P>] (explaining that ALJs conduct hearings “in a manner similar to non-jury trials in the federal district courts,” then prepare decisions after parties have had the opportunity to submit briefs and proposed findings of fact and conclusions of law).

46. See 17 C.F.R. §§ 201.300–360 (setting out the SEC's rules regarding hearings).

47. *E.g.*, *Fed. Mar. Comm'n v. S.C. Ports Auth.*, 535 U.S. 743, 758 (2002) (“[T]he role of the ALJ . . . is similar to that of an Article III judge.”); *Butz v. Economou*, 438 U.S. 478, 513 (1978) (“[T]he role of the modern . . . administrative law judge . . . is ‘functionally comparable’ to that of a judge.”); see also Kent Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 798 (2013) (“Federal administrative law judges . . . are the demigods of federal adjudication.”).

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

49. 17 C.F.R. § 201.111(a), (c).

50. *Id.* § 201.111(b).

51. See *McKart v. United States*, 395 U.S. 185, 194–95 (1969) (“[N]otions of administrative autonomy require that the agency be given a chance to discover and correct its own errors.”); *Chau v. SEC*, 72 F. Supp. 3d 417, 435 (S.D.N.Y. 2014) (noting that SEC ALJs have authority to consider constitutional challenges to the fairness of the administrative hearing itself, “at least in the first instance”). SEC ALJs have issued initial decisions addressing a wide range of constitutional issues and common law defenses raised by respondents. See, e.g., *Harding Advisory LLC*, Initial Decision Release No. 734, 2015 WL 137642, at \*86 (ALJ Jan. 12, 2015) (considering equal protection and due process issues); *Michael A. Horowitz*, Initial Decision Release No. 733, 2015 WL 77529, at \*26 (ALJ Jan. 7, 2015) (considering respondent's defenses of laches and equitable estoppel); *John Thomas Capital Mgmt. Grp. LLC*, Initial Decision Release No. 693, 2014 WL 5304908, at \*2 (ALJ Oct. 17, 2014) (considering the impartiality of an SEC tribunal and ex parte communication between prosecutor and ALJ).

Procedure.<sup>52</sup> These rules differ from the court rules; for example, any evidence that “can conceivably throw any light upon the controversy,” including hearsay, “normally” is admissible.<sup>53</sup> Depositions are rare—although this differs little from federal cases developed by agency employees, let alone criminal prosecutions.<sup>54</sup> Some motions, including motions to dismiss, are unavailable.<sup>55</sup>

The agency’s statute and Rules of Practice provide for a so-called “rocket docket.” An initial hearing must take place not more than sixty days after the notice instituting proceedings, unless the respondent consents to an extension.<sup>56</sup> The ALJ must issue an initial decision within at most three hundred days of the date of the order instituting proceedings, although the agency can seek a single, month-long extension; in a three hundred day proceeding, the hearing must be held within four month of the filing of the complaint.<sup>57</sup> The agency has recently proposed to double the length of time between complaint and hearing to eight months.<sup>58</sup> In federal court, of course, few litigated proceedings are concluded in such a brief period.<sup>59</sup> Otherwise, as we have observed, SEC ALJs enjoy many of the powers that trial judges have.<sup>60</sup>

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52. 17 C.F.R. § 201.

53. Jay Alan Ochanpaugh, Opinion of the Commission, Exchange Act Release No. 54,363, 88 SEC Docket 2510, 2515 n.29 (Aug. 25, 2006) (quoting Jesse Rosenblum, Investment Advisers Act Release No. 913, 30 SEC Docket 692, 696 (May 17, 1984)).

54. See 17 C.F.R. §§ 201.233–.234 (setting forth the availability of and procedure for taking depositions). As the SEC’s Director of Enforcement has said, however, “[t]he Federal Rules of Criminal Procedure allow for depositions only in ‘exceptional circumstances,’ which is similar to what the Commission’s Rules of Practice allow.” Ceresney, *supra* note 43.

55. See Jeffrey L. Feldman, Admin. Proc. File No. 3-8063, SEC Release No. 403, 55 SEC Docket 2477, 2478 (ALJ Jan. 14, 1994) (“[U]nder Rule 11 of the Commission’s Rules of Practice the first opportunity I have to rule on a motion which would dispose of a proceeding is at the conclusion of the Division’s direct case . . . . I have no authority to rule on the motions at this stage of the proceeding.”).

56. 15 U.S.C. § 78u-3(b) (2012). The rocket docket was implemented by rule in 2003. For a discussion, see Charles R. Mills et al., *Litigating Administrative Proceedings: The SEC’s Increasingly Important Enforcement Alternative*, in THE SECURITIES ENFORCEMENT MANUAL 323, 327–28 (Michael J. Missal & Richard M. Phillips eds., 2d ed. 2007).

57. 17 C.F.R. § 201.360.

58. Amendments to the Commission’s Rules of Practice, 80 Fed. Reg. 60,091, 60,092 (Oct. 5, 2015) (to be codified at 17 C.F.R. pt. 201) (“The amended rule would provide that the hearing must be scheduled to begin approximately four months after service of the order instituting proceedings, but not later than eight months after service of the order.”).

59. See Joe Palazzolo, *In Federal Courts, the Civil Cases Pile Up*, WALL STREET J. (Apr. 6, 2015, 2:09 PM), <http://www.wsj.com/articles/in-federal-courts-civil-cases-pile-up-1428343746> [<https://perma.cc/4AAA-BXU9>] (reporting that civil suits are “piling up” in federal court and that “[m]ore than 14% of civil cases in [one] district have been pending for three years or more”).

60. 5 U.S.C. §§ 556–57 (2012) (setting forth the procedures for formal adjudications presided over by an ALJ).

Appeals from an ALJ's "initial decision" are made to the SEC itself, which can amend or reverse the decision, although it usually does not.<sup>61</sup>

If dissatisfied with the decision of the agency (or nondecision, if the agency adopts the decision of the ALJ), petitioners can then appeal to a federal appeals court.<sup>62</sup> There, their claims will be evaluated under the deferential standards of review provided by administrative law.<sup>63</sup> In particular, the ALJ's factual findings, if accepted by the agency, will be reviewed under the "substantial evidence" standard.<sup>64</sup> By contrast, in federal trial court, the agency must establish facts through a preponderance of the evidence standard.<sup>65</sup> All courts, whether administrative or Article III, generally apply the doctrines of collateral estoppel and *res judicata* to final determinations by agency judges, which can affect decisions whether to settle in cases where claims are being brought against defendants in other fora by, say, state attorneys general or private plaintiffs.<sup>66</sup>

ALJs receive career appointments; their terms are not time limited.<sup>67</sup> They may be removed from their position only for good cause, which must be "established and determined" by the Merit Systems Protection Board

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61. See Jean Eaglesham, *SEC Wins with In-House Judges*, WALL STREET J. (May 6, 2015, 10:30 PM), <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803> [<https://perma.cc/VB4T-CQPE>] (recognizing "the SEC's high success rate in appeals of its administrative law judges' rulings"); *Office of Administrative Law Judges*, *supra* note 45 (explaining that parties can appeal an initial decision to the Commission, which can "affirm, reverse, modify, set aside, or remand for further proceedings").

62. 5 U.S.C. § 702.

63. Though it is not clear that the deferential nature of the standards makes much of a difference. See David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135, 140 (2010) ("I infer a developing consensus that the various standards, in the end, look to reasonableness as the baseline for evaluating agency action."). Nonetheless, Judge Jed Rakoff of the Southern District of New York has observed that "while the decisions of federal district courts on matters of law are subject to *de novo* review by the appellate courts, the law as determined by an administrative law judge in a formal administrative decision must be given deference by federal courts unless the decision is not within the range of reasonable interpretations." Jed S. Rakoff, U.S. Dist. Judge for the S. Dist. of N.Y., *PLI Securities Regulation Institute Keynote Address: Is the S.E.C. Becoming a Law Unto Itself?* (Nov. 5, 2014), <https://securitiesdiary.files.wordpress.com/2014/11/rakoff-pli-speech.pdf> [<https://perma.cc/YV2L-J6GN>].

64. See *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 477–79 (1951) (discussing at length what the substantial evidence standard requires).

65. On appeal, the federal court's factual findings would be reviewed for an abuse of discretion, or if a jury was involved, be reviewed at least as deferentially as would be an appeal from an agency factfinding, done on a substantial evidence standard. FED. R. CIV. P. 52(a)(6) ("Findings of fact, whether based on oral or other evidence, must not be set aside unless clearly erroneous, and the reviewing court must give due regard to the trial court's opportunity to judge the witnesses' credibility.")

66. See *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 107 (1991) ("We have long favored application of the common-law doctrines of collateral estoppel . . . and *res judicata* . . . to those determinations of administrative bodies that have attained finality."); *Mills et al.*, *supra* note 56, at 338 (noting the importance of collateral estoppel considerations in administrative proceedings).

67. 5 C.F.R. § 930.204(a) (2016).

(MSPB).<sup>68</sup> The SEC commissioners are the officers who would remove the administrative judges, and they themselves are removable only for “inefficiency, neglect of duty or malfeasance in office.”<sup>69</sup> Members of the MSPB who hear the case against SEC ALJs are also removable only for the same reasons.<sup>70</sup>

All of these doctrines make the ALJs insulated and the process before them different from that in district court. But administrative defendants enjoy one advantage over those charged in district court. The SEC’s Rules of Practice impose a *Brady*<sup>71</sup> obligation on the agency—a requirement that it turn over all exculpatory information to the defendant before any hearing—which applies only to criminal defendants in federal court and not to civil defendants in other contexts.<sup>72</sup>

The availability of *Brady* discovery has not persuaded practitioners that they benefit from being hauled before an ALJ. Lawyers often worry about administrative proceedings. “If given a choice . . . most practitioners would likely choose” district court “because of the availability of powerful discovery tools under the Federal Rules of Civil Procedure and a wholly independent adjudicator,” opine the authors of one treatise.<sup>73</sup> William McLucas, a former enforcement head at the agency, and a current leader of the defense bar, has also expressed concern:

With limited ability to obtain documents needed for a defense, with no opportunity to depose witnesses like the SEC did during the often multiyear investigation leading to the charges, and with insufficient time to locate defense expert witnesses to respond to the SEC’s experts, these proceedings can be stacked in favor of the SEC.<sup>74</sup>

These criticisms have increased since the SEC has brought more proceedings, and more high-profile proceedings, before ALJs.<sup>75</sup>

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68. 5 U.S.C. § 7521(a) (2012).

69. *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 619 (2d Cir. 2004) (internal quotations omitted) (quoting *SEC v. Blinder, Robinson & Co.*, 855 F.2d 677, 681 (10th Cir. 1988)).

70. 5 U.S.C. § 1202(d).

71. *Brady v. Maryland*, 373 U.S. 83 (1963).

72. See 17 C.F.R. § 201.230(a)(1) (2015) (“[T]he Division of Enforcement shall make available for inspection and copying by any party documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division’s recommendation to institute proceedings.”).

73. *Mills et al.*, *supra* note 56, at 327.

74. William McLucas & Matthew Martens, *How to Rein in the SEC*, WALL STREET J. (June 2, 2015, 6:55 PM), <http://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747> [<https://perma.cc/85NS-CEK3>].

75. See *id.* (indicating that the public perceives the increased use of administrative proceedings as a means for the SEC to circumvent unfavorable decisions in federal court).

### C. Remedies

ALJs cannot punish precisely in the way a district court judge can. Only a federal judge may issue an order pursuant to § 21(d)(2) of the Securities Exchange Act, prohibiting a person from serving as an officer or director of a public company.<sup>76</sup> Only a judge can require forfeiture of incentive-based or stock-based compensation following a restatement of financial statements under § 304 of Sarbanes-Oxley.<sup>77</sup> And, of course, only a judge can hear criminal cases for violations of the securities laws.<sup>78</sup>

But ALJs hold real powers over defendants, given the sanctions that they may impose.<sup>79</sup> The cease-and-desist, let alone the disbarment, power matters because it can be used for injunctions of real length. Refusing to permit a person the right to practice before the SEC means, for brokers, accountants, and others, that their careers are over.

Moreover, ALJs can impose substantial damages and fines. The SEC's ability to enter civil monetary penalties was, until the passage of Dodd-Frank, limited to registered persons or firms.<sup>80</sup> Monetary penalties remain relatively small: up to \$160,000 for individuals and \$775,000 for corporations for each violation of the laws (the maximum number is adjusted for inflation).<sup>81</sup> In addition to the civil penalties, the statute

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76. 15 U.S.C. § 78u(d)(2) (2012) (“[T]he court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person . . . from acting as an officer or director of any issuer that has a class of securities registered . . .”).

77. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-104, § 304(a), 116 Stat. 745, 778 (codified at 15 U.S.C. § 7243(a) (2012)). For a discussion of this so-called clawback power by an SEC official, see generally Rachael E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 BUS. LAW. 1 (2008).

78. The SEC does not have the power to prosecute criminal matters, for that matter; it instead investigates the crimes and relies upon the Department of Justice to bring the case. See 17 C.F.R. § 202.5(f) (2015) (memorializing this relationship as a matter of SEC policy). For a discussion, see Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 645 (2010) (“Although the SEC makes independent decisions to bring civil enforcement actions, the Department of Justice and the relevant U.S. Attorney’s offices filter criminal referrals.”).

79. See *Office of Administrative Law Judges*, *supra* note 45 (discussing sanctions that ALJs may impose, including “cease-and-desist orders; investment company and officer-and-director bars; censures, suspensions, limitations on activities, or bars from the securities industry . . . [and] civil penalties,” among other sanctions).

80. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, § 101, 104 Stat. 931, 934 (1990) (codified at 15 U.S.C. § 77t(d) (2012)) (limiting enforcement to registered entities and associated persons); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 1862 (1990) (codified in scattered sections of 15 U.S.C.) (allowing the SEC to seek civil penalties in administrative proceedings against nonregistered persons and entities).

81. 17 C.F.R. § 201.1005 tbl.V.

provides that in any proceeding in which the SEC can impose a penalty, the Commission can also “enter an order requiring accounting and disgorgement.”<sup>82</sup>

Disgorgement can be punishingly large.<sup>83</sup> The agency defines disgorgement as “the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible.”<sup>84</sup> But disgorgement is intended to deprive a wrongdoer of ill-gotten gains.<sup>85</sup> The agency views disgorgement not as primarily designed to compensate victims, but instead as a critical deterrent to violations of the securities laws.<sup>86</sup> As a consequence, disgorgement avoids some of the almost philosophical difficulties posed by questions of investor harms assuming diversified holdings and efficient markets, and gives the agency an avenue that can be used to establish a large monetary award.

To this end, the SEC need only show that the amount sought is a “reasonable approximation of profits causally connected to the violation.”<sup>87</sup> An order for disgorgement creates a personal liability for the defendant just as a civil penalty would, and the defendant must pay the disgorgement amount regardless of whether he or she retained the proceeds of the violation.<sup>88</sup> Moreover, the remedy reaches more than ill-gotten gains made through illegal trades. The SEC deems disgorgement to include salary earned during violation of the securities laws.<sup>89</sup> It can even include the disgorgement of a benefit received by someone else.<sup>90</sup>

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82. 15 U.S.C. § 78u-2(e).

83. While the 1990 statute explicitly gave the SEC the power to seek disgorgement in the federal forum, the SEC has long sought disgorgement as an equitable remedy in enforcement actions in federal court. *See, e.g.,* Russell G. Ryan, *The Equity Façade of SEC Disgorgement*, 4 HARV. BUS. L. REV. ONLINE 1, 2–3, 2 n.12 (2013), [http://www.hblr.org/wp-content/uploads/2013/11/Ryan\\_The-Equity-Fa%C3%A7ade-of-SEC-Disgorgement.pdf](http://www.hblr.org/wp-content/uploads/2013/11/Ryan_The-Equity-Fa%C3%A7ade-of-SEC-Disgorgement.pdf) [<https://perma.cc/TG3D-6PD5>] (“In practice, . . . the SEC rarely uses administrative proceedings to pursue contested disgorgement claims, preferring instead to file and litigate such claims in federal court.”).

84. U.S. SEC. & EXCH. COMM’N, AGENCY FINANCIAL REPORT: FISCAL YEAR 2014, at 66 n.9 (2014), <https://www.sec.gov/about/secpar/secpar2014.pdf> [<https://perma.cc/DD7S-FRLK>].

85. SEC v. Teo, 746 F.3d 90, 105 (3d Cir. 2014); *see also* SEC v. Contorinis, 743 F.3d 296, 301 (2d Cir. 2014) (“Disgorgement is an equitable remedy, imposed to ‘forc[e] a defendant to give up the amount by which he was unjustly enriched.’” (alteration in original) (quoting FTC v. Bronson Partners, 654 F.3d 359, 372 (2d Cir. 2011))).

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

87. SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989).

88. *Whitemore*, 659 F.3d at 9 (“[A] disgorgement order pertains to a sum equal to the amount wrongfully obtained, rather than a requirement to replevy a specific asset, and establishes a personal liability, which the defendant must satisfy regardless [of] whether he retains the selfsame proceeds of his wrongdoing.” (second alteration in original) (internal quotations omitted)).

89. *See* Richard F. Albert, *Punishment Without Cause: Disgorgement and Forfeiture of Salary and Pensions*, FORBES INSIDER (Apr. 2, 2014, 12:57 PM), <http://www.forbes.com/sites/>

The SEC collects significantly more in disgorgement than it does in civil penalties. In fiscal year 2014, the SEC collected \$1.378 billion in penalties.<sup>91</sup> But during this same period, the SEC collected more than twice as much in disgorgement of illegal profits: approximately \$2.788 billion.<sup>92</sup>

Civil penalties were the vehicle for the change in Dodd-Frank that has made ALJs such a newly important part of the SEC enforcement mix. Dodd-Frank increased the size of civil penalties available in the administrative forum, although these are still quite small.<sup>93</sup> More importantly, the Penny Stock Act limited the civil penalty power to regulated entities, as we have observed.<sup>94</sup> Dodd-Frank eliminated this distinction, opening the possibility of civil penalties against anyone in violation of the securities laws.<sup>95</sup> And while the statutory penalties are small (though significant to individual respondents), the statute provides that the SEC may seek disgorgement in any proceeding where it seeks a civil penalty.<sup>96</sup>

#### D. Administrative Adjudication Today

The SEC's ALJ program has provoked a great deal of consternation since the Dodd-Frank amendments expanded it, but a systematic look at the program in the last half decade suggests that this consternation is only modestly warranted and also somewhat misplaced. The SEC does not always win before its ALJs, though it usually obtains part of what it seeks.<sup>97</sup>

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

90. Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC’s Fair Fund Distributions*, 67 STAN. L. REV. 331, 340 n.50 (2015).

91. These figures include both orders from SEC cease-and-desist proceedings, as well as enforcement actions in federal court. U.S. SEC. & EXCH. COMM’N, SELECT SEC AND MARKET DATA: FISCAL 2014, at 2 tbl.1 (2014), <http://www.sec.gov/about/secstats2014.pdf> [https://perma.cc/UQ6G-ZZ24] [hereinafter SEC FISCAL DATA 2014].

92. *Id.*

93. 15 U.S.C. § 77h-1(g) (2012) (allowing imposition of civil penalties but capping the maximum penalty available at \$150,000 for a natural person or \$725,000 for a corporation). These penalties represent a 50% increase over the penalties applicable to broker-dealers prior to Dodd-Frank.

94. *See supra* note 80; *see also* 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/E68Y-MTC7] (explaining that in 1990, “the SEC could only obtain monetary penalties in a civil action” from nonregulated entities).

95. 15 U.S.C. § 77h-1(g).

96. *Id.* § 77h-1(e).

97. *See, e.g.*, Aruna Viswanatha, *Amid Cries of Home Field Advantage, SEC Loses Case in In-House Court*, WALL STREET J. MONEYBEAT (Mar. 19, 2015, 2:15 PM), <http://blogs.wsj.com/>

Nor is every case before an ALJ a big one. Those adjudicators spend most of their time routinely sanctioning very derelict registered companies, broker-dealers, or investment advisors, rather than high-profile insider traders or corporate officers. Nor do the ALJs do an obviously bad job. The opinions rendered by ALJs are organized and lengthy rather than cavalier; they do not look confused, but rather, in many ways, mimic the look and feel of securities law opinions rendered by Manhattan district judges, if not the perspective.<sup>98</sup> Nor has it mattered, at least when the opinions issued since Dodd-Frank are compared, which ALJ decides which case; there are not adjudicators more likely to rule for the SEC than others. A multivariate logistic regression suggests that the best predictors of success against the agency before ALJs lie in the sort of representation that defendants have obtained and whether they are publicly traded companies alleged to have made errors in their public filings.<sup>99</sup> The picture is in many ways reassuring. ALJs do not, on the surface, offer a particularly different form of justice than do federal courts, and they do require the SEC Enforcement Division to be put through its paces. In the end, the government usually wins, but administrative agencies usually win in the federal courts as well.<sup>100</sup>

*1. How Much Has SEC Policy Changed?*—The agency has turned to administrative adjudication, as one might expect, given Congress’s decision to broaden the jurisdiction of ALJs, but it remains active in district court. The SEC’s Enforcement Director, Andrew Ceresney, has explained that because of the Dodd-Frank amendments, the Commission can “obtain many—though not all—of the same remedies in administrative proceedings as [it] could get in district court.”<sup>101</sup> Accordingly, he has admitted, “we are using administrative proceedings more.”<sup>102</sup>

But this change in policy can be overstated by its critics. More cases are being brought administratively, but most of the proceedings filed before ALJs still involve registered individuals or firms, which have been eligible

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moneybeat/2015/03/19/amid-cries-of-home-field-advantage-sec-loses-case-in-in-house-court/ [https://perma.cc/YY9E-7LJJ] (discussing the SEC losing a case in front of an ALJ).

98. In Part III of this Article, the different perspectives of corporate lawyers and administrative lawyers will be compared and found to be quite different.

99. See *infra* tbl.1.

100. Zaring, *supra* note 63, at 140 (observing that regardless of the standard of review, agencies tend to win roughly two-thirds of the cases they litigate in the courts of appeals).

101. Ceresney, *supra* note 43. To be sure, the SEC recently issued guidance on how it chooses between filing cases in court and before in-house judges. It emphasized that “[t]here is no rigid formula dictating the choice of forum.” U.S. SEC. & EXCH. COMM’N, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS 1 (n.d.), <https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf> [https://perma.cc/TUA9-LFZH].

102. Ceresney, *supra* note 43.

for administrative proceedings since 1990.<sup>103</sup> It also appears, though it is difficult to detect from aggregate numbers, almost by definition, that the SEC is bringing more high-profile cases of securities fraud and insider trading administratively.<sup>104</sup>

Administrative proceedings are certainly increasing, as are damages. Before 2010, the agency initiated less than 400 administrative claims per year; after 2010, it initiated substantially more than 400; in 2014, it brought 610, a record.<sup>105</sup> Monetary penalties have increased. As former commissioner Paul Atkins has put it, the agency's policy was that "penalties should be assessed against [non-regulated entities] only in the rare situation where the [entity] received a 'direct economic benefit.'"<sup>106</sup> Between 1990 and 2002, the Commission brought only four monetary penalties cases against nonregulated entities, obtaining total damages of less than \$5 million.<sup>107</sup> As we have seen, the SEC imposed \$4.17 billion in fines and penalties in fiscal year 2014.<sup>108</sup>

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103. See *infra* note 105.

104. For more on the fuzziness of the SEC's numbers, see Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. (forthcoming 2016) (manuscript at 18–19).

105. The number of proceedings brought in the administrative forum each year as reported by the SEC: 2006 (356), 2007 (394), 2008 (386), 2009 (352), 2010 (429), 2011 (469), 2012 (462), 2013 (469), 2014 (610). SEC FISCAL DATA 2014, *supra* note 91, at 3 tbl.2; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2013, at 3 tbl.2 (2013) [hereinafter SEC FISCAL DATA 2013], <https://www.sec.gov/about/secstats2013.pdf> [<https://perma.cc/CN9S-M3VF>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2012, at 3 tbl.2 (2012) [hereinafter SEC FISCAL DATA 2012], <https://www.sec.gov/about/secstats2012.pdf> [<https://perma.cc/W4XK-WN33>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2011, at 3 tbl.2 (2011) [hereinafter SEC FISCAL DATA 2011], <https://www.sec.gov/about/secstats2011.pdf> [<https://perma.cc/BF27-BZ5Y>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2010, at 3 tbl.2 (2010), <https://www.sec.gov/about/secstats2010.pdf> [<https://perma.cc/9LSE-YFH2>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2009, at 3 tbl.2 (2009), <https://www.sec.gov/about/secstats2009.pdf> [<https://perma.cc/82Z7-ZALU>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2008, at 3 tbl.2 (2008), <https://www.sec.gov/about/secstats2008.pdf> [<https://perma.cc/JT83-F55K>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2007, at 3 tbl.2 (2007) [hereinafter SEC FISCAL DATA 2007], <https://www.sec.gov/about/secstats2007.pdf> [<https://perma.cc/TDA9-SYHZ>]; U.S. SEC. & EXCH. COMM'N, SELECT SEC AND MARKET DATA: FISCAL 2006, at 3 tbl.2 (2006), <https://www.sec.gov/about/secstats2006.pdf> [<https://perma.cc/JL3N-REY6>]. But, of course, the SEC's numbers are not something on which we should blindly rely. See Velikonja, *supra* note 104 (manuscript at 22, 57 tbl.2) (illustrating "inconsistencies in the SEC's reports" by calculating the reported number of enforcement actions less incorrectly categorized enforcement actions).

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

107. Ryan Jones, Comment, *The Fight over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 513 (2015).

108. See *supra* notes 89–90 and accompanying text.

Although a great deal of attention has been paid to high-profile cases directed to ALJs, such as those against the flamboyant financier Lynn Tilton and the former McKinsey CEO Rajat Gupta, the mix of traditional cases to new cases has not changed much in the aggregate.<sup>109</sup> Of the SEC's 610 administrative proceedings initiated in 2014, more than half of them were in three categories: “[b]roker-[d]ealer,” “[d]elinquent [f]ilings,” and “[i]nvestment [a]dvisors/[i]nvestment [c]ompanies” cases.<sup>110</sup> All three of these areas involve regulated entities that were unaffected by the Dodd-Frank changes to the administrative cease-and-desist proceedings. These are areas where the SEC traditionally brings comparatively few civil actions in federal court.<sup>111</sup>

The SEC has brought some administrative actions in cases that are traditionally associated with civil enforcement in federal court, although this is not unprecedented. For example, 2014 featured twelve administrative proceedings brought for insider trading.<sup>112</sup> But the SEC brought ten insider trading cases in the administrative forum in 2007, meaning that the defendants then would have been accountants, broker-dealers, investment advisors, or others registered with the commission.<sup>113</sup> On the other hand, its use of the proceedings to hear foreign corrupt practices cases is new, although the number of such cases brought per year is in the single digits.<sup>114</sup>

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

2. *SEC Administrative Proceedings Since the Enactment of Dodd-Frank: An Analysis of Five Years of Initial Decisions.*—It could, however, be the case that the matters brought before the ALJs enjoyed a strong home-court advantage, and further, it could be the case that the experiences for defendants would differ between federal court and administrative proceedings. As far as the processes between the two jurisdictions go, there is little doubt that the differences are distinctive—the rocket docket alone requires it, as do the rules of evidence, the lack of a jury, and the like.<sup>115</sup>

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

110. SEC FISCAL DATA 2014, *supra* note 91, at 3 tbl.2.

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

112. *Id.*

113. SEC FISCAL DATA 2007, *supra* note 105, at 3 tbl.2.

114. SEC FISCAL DATA 2014, *supra* note 91, at 3 tbl.2; SEC FISCAL DATA 2013, *supra* note 105, at 3 tbl.2; SEC FISCAL DATA 2012, *supra* note 105, at 3 tbl.2; SEC FISCAL DATA 2011, *supra* note 105, at 3 tbl.2.

115. See *supra* subpart I(B) for a discussion of these differences.

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

*a. Data.*—Between the passage of Dodd-Frank on July 22, 2010 and March 27, 2015, SEC ALJs issued 359 initial judgments.<sup>116</sup> All of these decisions were collected and read. They were coded for the representation of the defendant (pro se, represented,<sup>117</sup> or uncontested), the identity of the ALJ who wrote the decision, the statutory basis for the SEC's complaint, and whether the SEC “won”—that is, whether it received all the relief it sought, coded as a 1,0 variable. The exceptional cases—where the SEC comprehensively lost—are also considered qualitatively, but if the claim is that the SEC always wins before its ALJs, then assessing whether it receives all of the relief it seeks is an appropriate test.

In fiscal year 2014, the SEC won every administrative case that went to a judgment, including all fourteen cases that went to trial.<sup>118</sup> The SEC has not been uniformly successful, however, comprehensively losing cases in the administrative forum in 2011,<sup>119</sup> three times in 2013,<sup>120</sup> and once in 2015.<sup>121</sup> Much more often, it fails to get all the relief it seeks; graded on

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116. This means that the opinions of ALJs can be considered, but these offer only a partial, and likely, picture of what the universe of administrative proceedings suggests. For a dataset collected in 2007–2009, “[d]efendants settled with the SEC in 90 percent of all cases in the dataset assigned to administrative proceedings.” Stavros Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 698 (2012).

117. It was difficult to identify whether and how attorney quality varied. See *infra* note 135 and accompanying text.

118. 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), <http://www.nationallawjournal.com/id=1202715464297/The-SECs-On-a-Long-Winning-Streak> [<https://perma.cc/25FH-FGKD>]. By contrast, in 2014, the SEC conducted seventeen federal court trials and lost seven. Bruce Carton, *SEC Riding Lengthy Unbeaten Streak in Administrative Proceedings*, COMPLIANCE WK. (Jan. 20, 2015), <https://www.complianceweek.com/blogs/enforcement-action/sec-riding-lengthy-unbeaten-streak-in-administrative-proceedings> [<https://perma.cc/5MVG-XWPG>].

119. See John P. Flannery, Initial Decision Release No. 438, 102 SEC Docket 1392, 1424 (ALJ Oct. 28, 2011) (finding no violation of securities laws after a lengthy administrative hearing where the SEC alleged material misstatements to shareholders); Alison Frankel, *SEC Loses Again: Agency Judge Clears State Street Execs*, REUTERS (Oct. 31, 2011), <http://blogs.reuters.com/alison-frankel/2011/10/31/sec-loses-again-agency-judge-clears-state-street-execs/> [<https://perma.cc/NYK9-DVHE>] (summarizing the *Flannery* decision).

120. Miguel A. Ferrer, Initial Decision Release No. 513, 2013 WL 5800586, at \*83 (ALJ Oct. 29, 2013); S.W. Hatfield, Initial Decision Release No. 504, 2013 WL 4806917, at \*4 (ALJ Sept. 10, 2013), *rev'd*, Exchange Act Release No. 73,763, 2014 WL 6850921 (Dec. 5, 2014); Jilaine H. Bauer, Initial Decision Release No. 483, 106 SEC Docket 438, 440–41 (ALJ Apr. 16, 2013).

121. Thomas R. Delaney II, Initial Decision Release No. 755, 2015 WL 1223971, at \*61 (ALJ Mar. 18, 2015) (finding no supervisory liability for one respondent in a Rule 204 case that went to

that tough curve, the agency only received all the remedies it sought in 71% of the initial decisions in the sample.

Analyzing these texts offers some insights into administrative proceedings, but not comprehensive ones. As with any project where adjudicative opinions are analyzed, those cases that settled, or that were never brought, are excluded from the data. Accordingly, the SEC's win rate in cases tried to an initial decision might reflect a high rate of success, or undersell how high the rate is. Moreover, the sample is not large, and there is no instrument or discontinuity design to the logistic regression analysis that follows, which would be a better practice. And variable collection exercises are always subject to omitted variables. The results here are only suggestive.

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

The ALJs who work for the SEC do not begin their time there as securities laws experts. Six adjudicators worked in the office during the period during which the sample of initial decisions was taken. All of these judges were lawyers; the legal educations offered by the group included law degrees from Harvard, Ohio State, Columbia, Boston University, University of Chicago, Loyola University of Chicago, and the University of Pennsylvania.<sup>122</sup> Three of the ALJs served as litigators at the Department of Justice, with no obvious expertise in securities cases.<sup>123</sup> Of these three, two handled a broad array of civil matters, while one took on military cases, including military discipline proceedings conducted at courts martial.<sup>124</sup> One ALJ worked at the Department of Labor, another at the FCC.<sup>125</sup> One ALJ, the one who had by far the most background in securities-like litigation, worked for some time at the Commodities Future Trading

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administrative hearing); *see also* Viswanatha, *supra* note 97 (providing a detailed account of how “the [SEC] lost part of its case” before an SEC ALJ).

122. David Zaring, ALJ Background Information 1–3 (Jan. 11, 2016) (unpublished manuscript) (on file with the Texas Law Review) (compiling biographical information about ALJs).

123. *Id.*

124. *Id.*

125. *Id.*

Commission (CFTC), a financial market regulator that does work not dissimilar to the SEC.<sup>126</sup>

But most of these ALJs spent time as agency judges before arriving at the SEC. The adjudicator with financial regulatory experience based on his time at the CFTC began his time as an adjudicator with the Social Security Administration (SSA), as did at least one other judge (the vast majority of ALJs begin their careers at the SSA, which employs the vast majority of federal judges). Another spent twenty years as an ALJ at the Department of Labor before joining the SEC.<sup>127</sup> As relative newcomers to securities work, these adjudicators did not come with a depth of knowledge about the nature of securities litigation or administrative proceedings at the SEC; nor would they have been known, and held in particular esteem, by the securities bar upon appointment.

The table of summary statistics below shows how the dataset of initial decisions broke down, and indeed it contains much of the information that will be of interest to those not statistically inclined.<sup>128</sup>

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126. *Id.*

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

128. I collected and coded the data with assistance from one research assistant, and received assistance with the statistical analysis from a graduate student in the University of Pennsylvania's economics department.

**Table 1: Summary Statistics**

<u>Representation</u>	Count <sup>129</sup>	Frequency %	SEC Wins %
Neither	180	52%	98.9%
Pro se	66	23%	81.81%
Contested	102	29%	70.6%
<b><u>Judges</u></b>			
Elliott	109	31.3%	88.1%
Foelak	110	31.6%	90.0%
Grimes	25	7.2%	96.0%
Mahony	17	4.9%	70.6%
Murray	76	21.8%	82.9%
Patil	11	3.2%	90.9%
<b><u>Section</u></b>			
12(g)	11	3.5%	100%
12(j)	150	47.6%	98.0%
13(a)	15	4.8%	100%
15(b)	90	28.6%	76.7%
203(f)	40	12.7%	72.5%
21C	5	1.6%	80.0%
4C	3	1.0%	33.3%
8A	1	0.3%	100%

NOTE.—ANOVA on SEC win percentage by representation yields  $p$ -value  $\approx 0$ , by judge yields  $p$ -value = 0.14, and by section yields  $p$ -value  $\approx 0$ .

*b. Qualitative Overview.*—The look and feel of these opinions is, in most cases, one of a standardized template, which is unsurprising given that ALJs' initial decisions are required to be thorough: the initial decision must include “[f]indings and conclusions, and the reasons or basis therefor, as to all the material issues of fact, law or discretion presented on the record” in addition to any order for relief.<sup>130</sup>

Initial decisions accordingly follow a pattern. ALJs begin with an overview, continue with a recounting of the facts, sometimes at great length, followed by a turn to the law, which is then applied to the facts, after which sanctions are discussed (except in the rather rare case where none are imposed), and concluding with an order. Even the citations are standard: a leading case on the factors to be considered when imposing

129. Each number represents an initial decision.

130. 17 C.F.R. § 201.360(b) (2015).

sanctions, *Steadman v. SEC*,<sup>131</sup> was cited in 239 of the 359 opinions in the sample. The opinions cluster around predictable matters; the modal basis for an opinion revokes the registrations that a company had filed to meet its filing obligations.

But by citing a standard set of administrative and judicial decisions, along with agency rules and regulations, and engaging in a comprehensive discussion of the facts found in the proceedings, the ALJs always produce a substantial record for review by the Commission and the courts. A short opinion revoking the registrations of companies might still produce almost 1,800 words, about the length of two op-ed columns.<sup>132</sup> A longer opinion might reach over 48,000 words, the length of a short book.<sup>133</sup> The average length of an initial decision is 6,800 words.

The lawyers who contest these cases vary between sole practitioners, and big-firm or boutique litigators who may also represent their clients in court as well.<sup>134</sup> Very large firms, even if they feature very large securities practices, certainly do not monopolize the administrative courtroom.<sup>135</sup> No lawyer or firm appeared in more than a handful of cases during this period. In 69 proceedings, the defendant appeared pro se; in 108, the defendant had representation.

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

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

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131. 603 F.2d 1126 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

132. *E.g.*, Pro-Tech Indus., Inc., Initial Decision Release No. 612, 2014 WL 2704313 (ALJ June 16, 2014).

133. *E.g.*, BDO China Dahua CPA Co., Initial Decision Release No. 553, 2014 WL 242879 (ALJ Jan. 22, 2014).

134. *See, e.g.*, Anthony Chiasson, Initial Decision Release No. 589, 2014 WL 1512024, at \*1 (ALJ Apr. 18, 2014) (represented by white-collar, criminal-defense boutique Morvillo LLP); Thomas R. Delaney II, Initial Decision Release No. 755, 2015 WL 1223971, at \*1 (ALJ Mar. 18, 2015) (one defendant represented by Haynes & Boone, LLP).

135. In my sample, WilmerHale, one of the largest law firms in the country, with one of the largest securities practices, appeared only twice. The law firm rating service Chambers & Partners put WilmerHale in its top rank of securities regulation practices in 2015. *Securities: Regulation—Nationwide*, CHAMBERS & PARTNERS, [http://www.chambersandpartners.com/12788/1127/editorial/5/1#3675\\_editorial](http://www.chambersandpartners.com/12788/1127/editorial/5/1#3675_editorial) [<https://perma.cc/9244-SG7H>] (describing WilmerHale as a “standout performer in the regulatory sphere with impressive depths of quality on both the advisory and enforcement sides”).

In other cases, the administrative proceedings follow judicial proceedings that have already resulted in adverse verdicts for the defendants for violating the securities or the criminal laws. The questions resolved in the follow-on administrative proceedings concern the imposition of further sanctions on those defendants. The Enforcement Division may seek collateral bars from participation in the securities markets (or parts of those markets) for a term of years or permanently. These proceedings are also ordinarily straightforward, although in some cases ALJs will pare back the sums sought by the Enforcement Division.

While most initial decisions concern mundane filing problems, high-profile cases have recently been routed towards the ALJs. For example, the agency's decision to prosecute the Chinese subsidiaries of the big multinational accounting firms for failing to assist investigations analyzing fraud allegations made against various Chinese corporations was handled administratively and fell within the sample.<sup>136</sup> That case was consistent with the traditional expertise of ALJs in administering the sanctions regime for accountants licensed to practice before the commission.

Other high-profile cases exemplify the sorts of follow-on proceedings that the agency commonly pursues after winning a securities fraud case against a defendant in federal court. Both of the hedge fund managers prosecuted for insider trading in the litigation that resulted in the Second Circuit's groundbreaking *Newman*<sup>137</sup> decision were brought up on administrative proceedings that resulted in initial judgments.<sup>138</sup> After being convicted in federal court, one of the defendants in the Galleon hedge fund case also faced follow-on administrative proceedings.<sup>139</sup>

Moreover, other cases that could have been brought in federal court have also been brought internally; a trader made infamous by Michael Lewis's book on the financial crisis, *The Big Short*, also generated an

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136. *BDO China Dahua CPA Co.*, 2014 WL 242879, at \*2 (initiating enforcement due to firms failing to "produce any audit work papers" for clients subject to SEC investigations). The firms argued that Chinese law prohibited them from producing the materials. *Id.* at \*78–80. The suspensions issued by the judge created an international incident. See Michael Rapoport, *Judge Suspends Chinese Units of Big Four Auditors*, WALL STREET J. (Jan. 23, 2014, 1:42 AM), <http://www.wsj.com/articles/SB10001424052702303448204579337183810731744> [https://perma.cc/7Z4M-ZTJT] (theorizing about potential fallout from the ALJ's decision).

137. *United States v. Newman*, Nos. 13-1837(L), 13-1917(Con.), 2013 WL 9825204 (2d Cir. 2013).

138. *Anthony Chiasson*, 2014 WL 1512024, at \*8; Todd Newman, Initial Decision Release No. 562, 2014 WL 507514, at \*5 (ALJ Feb. 10, 2014).

139. See Michael S. Steinberg, Initial Decision Release No. 690, 2014 WL 5141532, at \*2, \*7 (ALJ Oct. 14, 2014) (characterizing Steinberg as "a portfolio manager of a hedge fund affiliate" and finding for the SEC). For a discussion of the case, see Michelle Celarier, *SAC's Steinberg Nailed for Insider Trading, Faints in Court*, N.Y. POST (Dec. 18, 2013, 4:34 PM), <http://nypost.com/2013/12/18/jury-finds-sacs-steinberg-guilty-of-insider-trading/> [https://perma.cc/QVH2-C9DD].

opinion by an ALJ; that securities fraud case did not follow proceedings in federal court.<sup>140</sup> And I have already noted other such cases.<sup>141</sup>

The SEC certainly does well in these proceedings. But its record is not unblemished. The agency received everything it asked for only 70% of the time; that is not too different than the rule-of-thumb rate for victories by any federal agency in federal court.<sup>142</sup>

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

But in my sample, the SEC rarely lost cases that it pursued to the point at which an ALJ would issue a decision. I identified only 6 of the first 359 decisions issued since Dodd-Frank was enacted that rejected the arguments of the Enforcement Division wholesale.

In two of these cases, the ALJs refused to punish relatively small-time violators more than they had already been punished. One featured an accountant who had failed to update his registration and was later permanently barred from practice.<sup>143</sup> The ALJ declined to add to his woes by sanctioning him for completing audits while his registration had lapsed.<sup>144</sup> A second opinion declined to impose further penalties against a defendant who had already incurred penalties well beyond his ability to pay.<sup>145</sup>

In the other four cases, however, the defendants were high profile and well represented. Perhaps most notably, in 2011, an ALJ rejected a case against employees of State Street for misleading investors about the extent of subprime mortgage-backed securities held in an unregistered fund.<sup>146</sup> That case set back the SEC's efforts to hold more bankers liable for fraud in

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140. Harding Advisory LLC, Initial Decision Release No. 734, 2015 WL 137642, at \*2 (ALJ Jan. 12, 2015) (concerning "allegations of fraudulent misrepresentation involving the purchase of assets for collateralized debt obligations"). As Reuters put it: "In October, the regulator charged collateral manager Harding Advisory LLC and its owner Wing Chau, a character in Michael Lewis' book 'The Big Short,' with fraud in connection with the Octans CDO." Jonathan Stempel, *Bank of America's Merrill To Pay \$132 Million in SEC Case over Mortgages*, REUTERS (Dec. 12, 2013, 4:24 PM), <http://www.reuters.com/article/2013/12/12/us-sec-bankofamerica-merrill-settlement-idUSBRE9BB11620131212> [<https://perma.cc/3BLX-2AF2>]. For other examples, see *supra* notes 1–4.

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

142. Zaring, *supra* note 63, at 171 tbl.1.

143. S.W. Hatfield, Initial Decision Release No. 504, 2013 WL 4806917, at \*1–2 (ALJ Sept. 10, 2013), *rev'd*, Exchange Act Release No. 73,763, 2014 WL 6850921 (Dec. 5, 2014).

144. *Id.* at \*1.

145. David Mura, Initial Decision Release No. 753, 2015 WL 1052404, at \*1 (ALJ Mar. 11, 2015).

146. John P. Flannery, Initial Decision Release No. 438, 102 SEC Docket 1392, 1424 (ALJ Oct. 28, 2011).

the run-up to the financial crisis, and cannot be characterized as a politically popular or supine opinion; indeed, the SEC commissioners themselves, over two dissents, overruled the opinion on appeal.<sup>147</sup>

Two other cases excused defendants charged with failing to supervise their subordinates, both of whom were engaged in work designed to comply with SEC rules. One featured a partner at Ernst & Young; the partner's subordinate was barred from practicing before the SEC for one year, but the partner escaped sanction.<sup>148</sup> In the other, charges against the CEO of a large multinational clearing firm were dismissed for his own failures to supervise his chief compliance officer.<sup>149</sup>

A final case against relatively high-level UBS financial advisors in Puerto Rico was deemed unproven.<sup>150</sup>

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

Much of the agency's success before the ALJs, moreover, can be attributed to the routine nature of most of the cases filed administratively.<sup>151</sup>

One concern regularly raised about the independence of ALJs has focused on their supervision by the agency's commissioners. There is little question that ALJs, as a general matter, enjoy a marked degree of formal independence from the agency for which they work, including all of the protections of independence set forth in the APA.<sup>152</sup> However, appeals from their initial decisions go to the Commission itself.<sup>153</sup>

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147. John P. Flannery, Opinion of the Commission, Securities Act Release No. 9689, Exchange Act Release No. 73,840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31,374, 2014 WL 7145625, at \*41–42 (Dec. 15, 2014).

148. Gerard A.M. Oprins, Initial Decision Release No. 411, 100 SEC Docket 393, 393, 415–16 (ALJ Dec. 28, 2010).

149. Thomas R. Delaney II, Initial Decision Release No. 755, 2015 WL 1223971, at \*1–2, \*61 (ALJ Mar. 18, 2015).

150. Miguel A. Ferrer, Initial Decision Release No. 513, 2013 WL 5800586, at \*71, \*74, \*83 (ALJ Oct. 29, 2013).

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

152. See *supra* notes 36–40 and accompanying text; see also 5 U.S.C. § 554(d)(1)–(2) (2012) (providing for separation of functions and limiting ex parte contacts between ALJs and agency employees); Harold H. Bruff, *Specialized Courts in Administrative Law*, 43 ADMIN. L. REV. 329, 346 (1991) (describing separation of powers for ALJs).

153. 5 U.S.C. § 557(b) (describing the process and powers for an agency when reviewing an ALJ decision); see also Barnett, *supra* note 47, at 806–07 (describing the power of an agency to reverse ALJ decisions).

We can get a sense of how independent ALJs are by looking at the review done by the Commission of our sample of initial decisions.<sup>154</sup> If we leave out ministerial affirmances, based on a failure to make or perfect an appeal, Commission review looks quite searching, even if it only is for approximately one out of six cases. One of the incantations of the commissioners, repeated at the beginning of many of its decisions, is that their decision would be based on an “independent review of the record.”<sup>155</sup> Ordinarily their decisions were lengthy enough to include a statement of facts, a legal analysis, and an evaluation of the appropriate form of relief.

Appeals where the Commission made some substantive decision could be identified in 55 cases. In 29 of these decisions, the Commission affirmed the initial decision of the ALJ. In 8 decisions, the Commission affirmed the decision directionally, but modified the remedy. In 18 cases, the Commission reversed the decisions of the ALJs. Overall, in those cases where the Commission has completed its review, it reversed or modified the judgments of the ALJs slightly less than half of the time.

The grounds for affirmance ranged from summary, shorthand recitations used to justify the more ministerial decisions (of, say, a failure to file that had not been remedied by the time the appeal was heard) to lengthy opinions vindicating the findings and conclusions of law of the ALJ. The Commission would modify cases by recalculating the remedy, perhaps to increase a fine or lower it, sometimes very slightly,<sup>156</sup> or to take a different position on a conclusion of law drawn by the judge.

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

But in cases where defendants did appeal, the agency often did so as well, seeking more severe sanctions than those imposed by the ALJ. On

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

155. Of the 197 initial decisions reviewed by the Commission in the five years, 46 included that term and others included terms like it. *SEC Commission Opinions & Orders Search*, BLOOMBERG L., [https://www.bloomberglaw.com/legal\\_search/results/94402b6b2af9b2f64a51482e505c1b6d](https://www.bloomberglaw.com/legal_search/results/94402b6b2af9b2f64a51482e505c1b6d) (follow “Search & Browse” hyperlink, then “All Legal Content”; then search keywords “‘initial decision’ & ‘independent review of the record’” and modify search criteria for source “SEC Commission Opinions & Orders” and date range 12/08/2010 to 12/08/2015).

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

those occasions where the administrative law judges ruled against the Enforcement Division, the Commission took an especially careful look. It reversed the leniency shown to the accountant<sup>157</sup> and the State Street banker.<sup>158</sup> But it never exclusively played the role of the bad cop; it sympathized, as did the ALJ, with one judgment proof defendant's penurious plight.<sup>159</sup>

We can also look for reviews in the courts of appeals of actions that began as initial decisions by ALJs. This was, as a general matter, exceedingly uncommon. Indeed, only two cases, *Pierce v. SEC*<sup>160</sup> and *Siris v. SEC*,<sup>161</sup> have resulted in reported decisions so far.<sup>162</sup> *Pierce* was a straightforward affirmance, albeit a reported one, of the SEC's actions; it reviewed both the decision of the ALJ and the review by the Commission, and disturbed neither. *Siris* also straightforwardly affirmed the decision of the SEC and conducted a similar inquiry. Although definitive conclusions would be premature, the lack of regular appellate review suggests that ALJ dialogue with the federal courts is more likely to happen through parallel or follow-on enforcement actions; as we have seen, the Commission frequently reverses its ALJs when it receives news of an adverse judicial opinion in a parallel proceeding after the ALJ has filed an initial decision.

*c. Quantitative Analysis.*—A *t*-test (*t*-tests compare the means of variables) indicated, unsurprisingly, that there is evidence suggesting that cases that are contested are more likely to be lost by the SEC, though no causal inference can be drawn from this. Factors relevant to understanding the SEC win rate could be estimated through logistic regression, which is appropriately used when the dependent variable is categorical with two levels (in this case, whether it won or not). A univariate regression of case

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157. S.W. Hatfield, Opinion of the Commission, Exchange Act Release No. 73,763, 2014 WL 6850921, at \*3–4 (Dec. 5, 2014).

158. John P. Flannery, Opinion of the Commission, Securities Act Release No. 9689, Exchange Act Release No. 73,840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31,374, 2014 WL 7145625, at \*40–41 (Dec. 15, 2014).

159. David Mura, Order Remanding Case for Further Proceedings, Exchange Act Release No. 72,080, 2014 WL 1744129, at \*1 (May 2, 2014); *see also* David Mura, Initial Decision Release No. 753, 2015 WL 1052404, at \*1 (ALJ Mar. 11, 2015) (deciding on remand that “no disgorgement or civil penalties will be imposed on David Mura”).

160. 786 F.3d 1027 (D.C. Cir. 2015).

161. 773 F.3d 89 (D.C. Cir. 2014).

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

outcome against ALJ does not support any inference that the ALJ authoring the opinion was associated with the different likelihoods that the SEC would win the case.<sup>163</sup> However, there is evidence that the choice by the defendant to be represented by counsel is associated with a significantly lower win rate for the SEC. Finally, a multivariate logistic regression of case outcome against ALJ, case section, and choice-of-representation level revealed, unsurprisingly, that representation still mattered—the SEC wins essentially all the time (98.9%) when the defendant has no representation, but receives all of the relief it seeks only 71% of the time when the case is fully contested.<sup>164</sup>

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

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

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

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

164. *See infra* app.

of how the securities laws might work and is a jurist before which the SEC repeatedly appears.<sup>165</sup>

The initial judgments issued by ALJs, the cases decided by all SDNY judges, and the cases decided by Judge Rakoff that touched on securities law since the passage of the Dodd-Frank Act can be compared quantitatively—specifically, the 359 initial decisions issued by ALJs between July 22, 2010 and March 27, 2015, compared to opinions in securities cases issued by our comparison judges.<sup>166</sup> During that same period, Judge Rakoff issued 47 securities decisions, that is, decisions where the cause of action was based on a securities statute, whether brought by a private plaintiff, the SEC, or the Department of Justice.<sup>167</sup> SDNY judges issued 799 securities law decisions.<sup>168</sup>

The tribunals' various citation practices speak to the increasingly distinct securities-law jurisprudences being developed by ALJs and the federal judiciary. Administrative law judges cite to previous administrative precedent more often. A typical initial judgment will have 8.6 cites to other reported SEC decisions. SDNY judges cited to ALJ opinions 9 times during this period, approximately 0.01 citations per opinion. Judge Rakoff almost never cites to administrative adjudications either. On average, in his 47 securities opinions, he would cite 0.04 administrative adjudications per opinion.

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

166. *Search Results for SEC ALJ Initial Decisions*, BLOOMBERG L., <https://www.bloomberglaw.com/p/3547e197a47ea5a9012e1f7601f0b538/search/results/da247e770afd3ab37d2235c30d2ea951> (using the Search and Browse feature within the source “SEC ALJ Initial Decisions” for the date range 7/22/2010–3/27/2015). Although this search pulls up 377 decisions, some decisions were removed as duplicates or procedural orders. This means that the opinions of ALJs can be considered, but these offer only a partial and likely picture of what the universe of administrative proceedings suggests. For a dataset collected in 2007–2009, “[d]efendants settled with the SEC in 90 percent of all cases in the dataset assigned to administrative proceedings.” Gadinis, *supra* note 116, at 698. For the complete dataset of opinions, see David Zaring, ALJ Initial Decisions (Apr. 5, 2016) (unpublished spreadsheet) (on file with the Texas Law Review).

167. *Search Results for Judge Rakoff's Securities Decisions*, BLOOMBERG L., [https://www.bloomberglaw.com/legal\\_search/results/cf304b7cef930d6c6e61caf4377748be](https://www.bloomberglaw.com/legal_search/results/cf304b7cef930d6c6e61caf4377748be) (using the Search and Browse feature within the source “U.S. District Court for the Southern District of New York Opinions” for the date range 7/22/2010–3/27/2015 and filtered to the topic “Securities Law” and the judge “Jed Saul Rakoff”).

168. *Search Results for SDNY Securities Law Decisions*, BLOOMBERG L., [https://www.bloomberglaw.com/legal\\_search/results/51b796d6b1203de8664f2ce62d6e6829](https://www.bloomberglaw.com/legal_search/results/51b796d6b1203de8664f2ce62d6e6829) (using the Search and Browse feature within the source “U.S. District Court for the Southern District of New York Opinions” for the date range 7/22/2010–3/27/2015 and filtered to the topic “Securities Law”).

But if federal judges do not care about the administrative decisions of the SEC, the contrary is not the case. ALJs cited to the Federal Reporter's Third Edition after the passage of Dodd-Frank roughly 3.8 times per opinion. That number paled in comparison with Judge Rakoff's citations, which amounted to 14.8 Federal Reporter citations per opinion. SDNY judges as a whole cited to the F.3d 13,673 times in their securities law decisions of the same period, or 17.4 such citations per opinion.<sup>169</sup>

In other ways, the opinions look similar. ALJs write shorter opinions—on average 6,200-word decisions since Dodd-Frank. Judge Rakoff's securities law opinions have amounted to 8,900 words, while the SDNY bench as a whole has averaged 12,500 words per opinion. The Flesch–Kinkaid Reading Ease Test scores, which measure the complexity of writing in a given text, are remarkably similar.<sup>170</sup> While the Harvard Law Review has a Flesch–Kinkaid score in the 30s,<sup>171</sup> and sentences with Flesch–Kinkaid scores of approximately 100 could be understood by an average fourth grader,<sup>172</sup> the combined decisions of administrative law judges had a Flesch–Kinkaid score of 61.8, while Judge Rakoff's securities law decisions over the same period had a very similar score of 62.1; SDNY judges registered as very slightly easier to read; they came in at 63.4.

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

It is accordingly not easy to detect enormous differences between ALJs, SDNY judges, and Judge Rakoff's securities law opinions other than the fact that federal judges are uninterested in the work of administrative

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169. But, of course, ALJs do not have to set forth the procedural citations, such as the standard of review for a particular motion, that are part and parcel of any federal court opinion. See 17 C.F.R. § 201.56 (2015) (setting forth the procedural requirements for an administrative law judge's initial decision).

170. For discussions and use of Flesch–Kincaid Readability Scores, see Florencia Marotta-Wurgler & Robert Taylor, *Set in Stone? Change and Innovation in Consumer Standard-Form Contracts*, 88 N.Y.U. L. REV. 240, 253 (2013) (measuring the readability of standard-form contracts); Joshua E. Perry et al., *Direct-to-Consumer Drug Advertisements and the Informed Patient: A Legal, Ethical, and Content Analysis*, 50 AM. BUS. L.J. 729, 759–60, 763 (2013) (using the scores to measure the readability of prescription drug advertisements); Daniel Schwarcz, *Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection*, 61 UCLA L. REV. 394, 421 (2014) (“[M]ost states do require policies to meet a specific quantitative readability score, usually a fifty or forty on the Flesch–Kincaid Reading Ease Score.”). For an overview of how the test works, see WILLIAM H. DUBAY, *THE PRINCIPLES OF READABILITY* 21–22, 50 (2004), <http://www.impact-information.com/impactinfo/readability02.pdf> [<https://perma.cc/5TRB-NPPZ>].

171. Aleecia M. McDonald et al., *A Comparative Study of Online Privacy Policies and Formats*, in *PRIVACY ENHANCING TECHNOLOGIES* 37, 41 (Ian Goldberg & Mikhail J. Atallah eds., 2009).

172. Lynn J. White et al., *Informed Consent for Medical Research: Common Discrepancies and Readability*, 3 ACAD. EMERGENCY MED. 745, 746 (1996).

adjudicators, an institutional focus not shared by the adjudicators themselves.

To compare the favorability of judicial enforcement to administrative proceedings for the agency, I identified the cases in the district during the period where the SEC brought enforcement claims against defendants.<sup>173</sup> Of the 119 such cases, the agency's success rate was high; successful outcomes in 111 of the cases could be tracked. Thirty-six Southern District judges heard cases during this period, and none of them were particular outliers in their small samples with regard to whether they voted with the SEC. Indeed, the only notable distinction was that Judge Rakoff heard 13 cases during the period—almost twice as many as did the next most active federal judge on SEC cases, Judge Shira Scheindlin with seven. The cases were almost evenly split between claims brought under 15 U.S.C. § 77 (54 of the 119 cases were reported under that statute), and 15 U.S.C. § 78m(a) (64 cases were brought under that statute), and the SEC's rate of success did not particularly differ between the two causes of action.<sup>174</sup>

Over the sample period, these results do make the SEC look like a comparably victorious enforcer regardless of the forum in which it chose to pursue enforcement; there is no statistically significant distinction between the rates of success. Nonetheless, the agency must worry not only about whether it is winning its routine cases, but whether it is winning the high-profile ones. With 8 failures in Manhattan, compared to only 6 over a larger number of enforcement proceedings brought before its ALJs, it may have had some reason to feel like the differences between the fora mattered not just for procedural reasons, but also for the sort of vindication the agency could expect by its choice.

4. *Conclusion.*—ALJs have been the subjects of controversy before the SEC's change in enforcement policy—many administrative lawyers think of them as costly and uncooperative implementers of agency agenda, who do so while insisting on their independence; the corporate bar appears to believe that it cannot win before them.<sup>175</sup> A close investigation of the initial decisions rendered by the adjudicators since the enactment of Dodd-Frank

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

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

175. See, e.g., Kent Barnett, *Due Process vs. Administrative Law*, WALL STREET J. (Nov. 15, 2015, 5:20 PM), <http://www.wsj.com/articles/due-process-vs-administrative-law-1447626023> [<https://perma.cc/6PRR-WFNQ>] (arguing that the agency supervision of ALJs creates an aura of partiality that is hard to ignore); 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/#2715e4857a0b27f52fa147ac> [<https://perma.cc/7CAE-6DU9>] (noting conflicts and frustrations with ALJs).

provides a clearer picture of what is going on in modern administrative adjudication. To deem it vibrant would require more comparisons, perhaps across agencies. It can be said that the SEC administrative proceedings program is a going concern, with a clear role inside the agency, and one that is expanding. At the SEC, administrative proceedings are elaborated in the way that federal court orders and opinions are, where in both contexts the defendant usually loses, but yet in neither do the outcomes look like *faits accomplis*.

## II. The Highly Uncertain Case Against ALJs

The constitutional arguments against the agency's new policy to bring more cases before ALJs range from a novel separation of powers claim that has prompted most of the suits against the agency to more traditional, if rarely vindicated, claims about due process, the right to a jury trial, and equal protection. All are creative enough but are, as a matter of doctrine, without merit, principally because ALJs are longstanding and respected fixtures of the administrative state.<sup>176</sup>

The appropriate way to review the agency's policy to route cases to ALJs is either as a matter committed to the agency's discretion, or possibly as a matter to which the agency is entitled to deference for any reasonable interpretation of its governing statute.<sup>177</sup> Because the agency's policy of initiating more administrative proceedings is a reasonable interpretation of the amendments to Dodd-Frank authorizing it to do so, there is little question that the SEC is reasonably interpreting congressional direction in the unlikely event that that undemanding standard is the appropriate one to apply.

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

177. This so-called *Chevron* deference is a doctrine that requires courts to defer to an agency's permissible construction of the authority-granting statute. *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844–45 (1984).

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

#### A. *Removal*

The most successful claim made against the SEC's ALJs is the most novel one, and is based on the Supreme Court's comparatively recent separation of powers case, *Free Enterprise Fund v. PCAOB*,<sup>178</sup> which cast doubt over agencies that enjoyed multiple layers of protection against at-will termination by the President.<sup>179</sup> The claim proves far too much, however—taken seriously it would undo the institution of formal adjudication in administrative law, an institution that has been upheld by the Supreme Court, either explicitly or implicitly, dozens of times.

The President's responsibility to take care that the laws be faithfully executed, among other things, means that he is entitled to some ability to remove some executive officers to ensure that they are responsive to his interests.<sup>180</sup> The power to remove has also been inferred from and shaped by the power to appoint certain senior executive officers, which must be vested in the President.<sup>181</sup> What this means in practice is that there must be

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178. 561 U.S. 477 (2010).

179. *Id.* at 508.

180. *See id.* at 483 (“Since 1789, the Constitution has been understood to empower the President to keep these officers accountable—by removing them from office, if necessary.”).

181. The sort of protections an officer may have is related to the constraints imposed by the Appointments Clause, which restricts the constraints that Congress may impose upon the authority of the President to choose his preferred candidates for important Executive Branch posts. Under Article II of the Constitution, “[t]he President . . . shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States.” U.S. CONST. art. II, § 2. The appointment of so-called inferior officers need not be subject to Senate confirmation, but the power to appoint them must be vested “in the President alone, in the Courts of Law, or in the Heads of Departments.” *Id.* It is these officers whose job security requires constitutional limitations, lest the President lose control over his Executive Branch. Many bemoaned that it has never been made clear by the Supreme Court what exactly makes a government official a principal officer of the United States needing Senate confirmation or an inferior officer or mere employee, who do not need confirmation. *See, e.g., Landry v. FDIC*, 204 F.3d 1125, 1132 (D.C. Cir. 2000) (“The line between ‘mere’ employees and inferior officers is anything but bright.”); Harold J. Krent, *Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government*, 85 NW. U. L. REV. 62, 72 n.26 (1990) (“The reach of the appointments clause, however, is unclear.”). But the majority in *Morrison v. Olson* announced a “core executive functions” test that involves, in the words of dissenting Justice Antonin Scalia, “[t]aking all things into account.” *Morrison v. Olson*, 487 U.S. 654, 669 (1988); *id.* at 733 (Scalia, J., dissenting).

some senior officers that may be removed at will by the President, and other, less important, senior officers that can enjoy “for-cause” protections against termination, but for-cause protections of limited scope.<sup>182</sup>

ALJs enjoy a great deal of job security—something that poses no constitutional problem for unimportant federal officials, such as, say, prison guards or prosecutors, all of whom enjoy strong civil service job protections—but that matters for the sorts of federal officials in a position to make, or frustrate, policy in the way the President would like.<sup>183</sup> Kevin Stack has observed that at least “some ALJs . . . possess more than purely recommendatory functions” about the disposition of cases,<sup>184</sup> which, if true in the SEC, might seem to make the officials important enough in the scheme of enforcement powers to warrant presidential supervision.

However, supervision is not something that the President can easily provide through the disciplinary ability to fire the adjudicator; Justice Breyer has observed that ALJs are “by statute, subject to two layers of for-cause removal,” which makes their relationship to the President insulated.<sup>185</sup> In fact, Justice Breyer understated the case. They can be removed from their posts only for cause,<sup>186</sup> and then only if the SEC, whose commissioners can only be removed from their posts for cause, brings a proceeding against the ALJ before the Merit Services Protection Board, an independent federal agency that also is comprised of members who may only be removed for cause.<sup>187</sup> Taken seriously, this triple layer of for-cause protection means that the President has very little ability to enact his preferred securities regulation policy by removing those inferior officers who hear cases brought by the SEC.

The removal concerns have been given a boost by the logic of *Free Enterprise Fund v. PCAOB*, where the Court held that “multilevel protection from removal is contrary to Article II’s vesting of the executive power in the President.”<sup>188</sup> The case arose out of disciplinary proceedings brought against an accounting firm by the Public Control Accounting Oversight Board, an institution within the SEC created in the Sarbanes-

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182. For-cause protection means that the officers could be terminated only because they are not doing their jobs well, not because they are doing their jobs in a way inconsistent with the policies of the President. For a discussion of the differences between for-cause and at-will employment, see generally Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984).

183. See Kevin M. Stack, *Agency Independence After PCAOB*, 32 CARDOZO L. REV. 2391, 2419 (2011) (concluding that separation of powers has a new endeavor of separating adjudicative powers “from policymaking and enforcement functions within the agency”).

184. *Id.* at 2409 n.101.

185. *Free Enter. Fund*, 561 U.S. at 556–57 (Breyer, J., dissenting).

186. 5 U.S.C. § 7521 (2012).

187. They are removable “by the President only for inefficiency, neglect of duty, or malfeasance in office.” *Id.* § 1202(d).

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

Oxley Act after a number of high-profile firms admitted to enormous misstatements in their annual reports in the wake of the collapse of the dot-com bubble at the turn of the century.<sup>189</sup> The Board was supposed to ensure that accounting firms were subject to professional and ethical standards that would make it unlikely that they would miss or be implicit in these sorts of misstatements in the future; its budget came largely from fees paid by the accounting industry, and its members, critically, enjoyed for-cause protection.<sup>190</sup>

The case posited that the control of the President over executive action is imperiled if the President cannot remove inferior officers of the United States protected by too much for-cause protection.<sup>191</sup> “The President cannot ‘take Care that the Laws be faithfully executed’ if he cannot oversee the faithfulness of the officers who execute them,” said Chief Justice John Roberts for the majority.<sup>192</sup> In *Free Enterprise Fund*, it was members of the PCAOB who could only be removed for cause by the commissioners of the SEC who, in turn (it was agreed) could only be removed for cause.<sup>193</sup>

Indeed, it is only through the *Free Enterprise Fund* case that the problem of bringing cases before ALJs becomes problematic. After all, the ALJs have existed for years, and the hearing examiners who preceded them were among the first instantiations of the federal bureaucracy, which was originally created more in the image of courts adjudicating cases, rather than in the image of rule makers writing prospective regulations.<sup>194</sup> No one has in that time argued that the President must have control over quasi-judicial decisions by only modestly empowered bureaucrats to truly execute the law.

Claims arguing that this structure, in light of *Free Enterprise Fund*, unconstitutionally burdens the President’s removal powers have been brought by most of the defendants whose cases have been routed to administrative proceedings and have persuaded a handful of judges.<sup>195</sup> The problem with these cases is that they seek to undo an institution that has been part of the furniture of administrative law since the passage of the APA. If taken seriously, they would undo most of the work of

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189. *Id.* at 484, 487–88.

190. *Id.* at 484–86.

191. *Id.* at 483–84.

192. *Id.* at 484.

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

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

195. For a review of some of these cases, see *supra* notes 16–17 and accompanying text.

administrative law judges, not just for the SEC, but also for other agencies as well.<sup>196</sup>

The Social Security Administration, which is the largest employer of ALJs in the government, depends upon them to process disability claims.<sup>197</sup> The International Trade Commission (ITC) has given its ALJs the responsibility to make initial decisions on whether imports that violate intellectual property protections should be banned from sale in the United States—a power to which American companies have resorted liberally.<sup>198</sup> It would be an avulsive change for agencies, and courts do not often hold important, longstanding institutions unconstitutional because of the application of a novel precedent that itself did little to affect the way the agency it targeted—the PCAOB—actually worked.

It is more likely that cases that waffled on establishing hearing officers as inferior officers of the United States would be revisited to avoid such a result.<sup>199</sup> If the ALJs are not deemed to be inferior officers, but rather civil service employees, then there is no removal-power problem posed by their triple-protected tenure.<sup>200</sup>

Conversely, the *Free Enterprise Fund* precedent could be interpreted to be limited to cases where the agency officials are engaged in nonadjudicatory activities, or only to apply to, as Rick Pildes has suggested, “Russian-doll” type agencies, like the PCAOB uncomfortably located inside the SEC.<sup>201</sup>

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196. Van Voris & Robinson, *supra* note 38 (“The five SEC judges are part of a much larger pool of almost 1,700 administrative judges working in 26 federal departments and agencies . . .”).

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

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

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

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

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

But there is no doubt that finding a *Free Enterprise* exception for ALJs is both doctrinally likely and sound policy. Claiming the importance of affecting the course of adjudications for enacting the policies of the President is a strange line to draw; we usually hope that our adjudicators will not be susceptible to the influence of parties outside of their tribunals.<sup>202</sup> ALJs, it is supposed, were created to deliver judicially comparable, trial-type justice.<sup>203</sup> That quality would be compromised if those judges were not independent or impartial, but subject to the influence of the President because of the power he could wield over their continued employment. But that is what a holding that the *Free Enterprise Fund* logic applied would require.

### B. *Equal Protection*

The equal protection claims made by prospective defendants against the SEC's new ALJ practice are rooted in a sense that those defendants who are prosecuted administratively are being treated unconstitutionally differently than those defendants who are sued by the agency in civil federal court. The doctrinal vehicle for the claim is the Equal Protection Clause, which requires the federal government to ensure that no person within its jurisdiction is denied "the equal protection of the laws."<sup>204</sup> The legal theory is that the selective filing of some defendants' cases before ALJs denies those defendants equal protection when similarly situated defendants enjoy the benefits of judicial jurisdiction, like rules of evidence and procedure.<sup>205</sup>

Ordinarily, the Equal Protection Clause is triggered by claims of discrimination by the government on the basis of race or gender.<sup>206</sup> Aggrieved targets of SEC enforcement have not levied such charges, however—they are arguing that the unfair discrimination lies in the selection of their case for administrative proceedings, while comparable cases go to court.<sup>207</sup>

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202. See R. Terrence Harders, *Striking a Balance: Administrative Law Judge Independence and Accountability*, J. NAT'L ASS'N ADMIN. L. JUDGES, Spring 1999, at 1, 2 (identifying the "perceived need for public confidence in administrative adjudications not subject to political and other outside influences" as an important influence on the formation of the APA).

203. See *infra* notes 222–24 and accompanying text, which describe the precedent analogizing ALJ proceedings and district court proceedings.

204. U.S. CONST. amend. XIV, § 1.

205. See *United States v. Armstrong*, 517 U.S. 456, 464–69 (1996) (setting forth the test for establishing selective prosecution).

206. See, e.g., *United States v. Virginia*, 518 U.S. 515, 531–34 (1996) (evaluating the Virginia Military Institute's policy that prohibited the admission of women to the school); *Armstrong*, 517 U.S. at 459 (weighing the allegation that the federal government selectively prosecuted black defendants for drug offenses).

207. E.g., *Chau v. SEC*, 72 F. Supp. 3d 417, 420–26 (S.D.N.Y. 2014); *Gupta v. SEC*, 796 F. Supp. 2d 503, 513–14 (S.D.N.Y. 2011).

Such claims are not unprecedented. “[S]uccessful equal protection claims [may be] brought by a ‘class of one,’ where the plaintiff alleges that she has been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment,” the Supreme Court has explained.<sup>208</sup> But they are rare, and require the courts to rather dramatically expand the usual focus of the Equal Protection Clause to deal not with disadvantaged minorities, but with well-heeled participants in the securities markets.

Moreover, the standard for making a constitutional claim for what essentially amounts to a selective prosecution argument by particular members of a group of not particularly differentiated businesspeople is a high one.<sup>209</sup> A selective prosecution argument requires the defendant to prove not just a disparate impact, but also intent on the part of the government to prosecute “because of” the defendant’s membership in an identifiable group—again, in this case, a group of whom whose peers received federal court trials.<sup>210</sup> But agencies make decisions to route cases in-house or towards courts frequently (indeed, the SEC implicitly does so in every case) and have done so for many years, and are generally thought to have unfettered discretion as to *whether* to prosecute, which can reasonably be read to include the discretion over *where* to do so.<sup>211</sup> Agencies almost never lose lawsuits on selective prosecution grounds.<sup>212</sup>

Nonetheless, the equal protection theory has won one battle. Judge Rakoff found that in a case where one member of a conspiracy faced charges that were to be brought before an ALJ, while the other twenty-seven members of the conspiracy had been sued by the SEC in federal court, the lone defendant had a plausible argument that he consisted of a so-called class of one that was being treated arbitrarily differently from his codefendants.<sup>213</sup> The court held that the respondent’s allegations that he had been “intentionally, irrationally, and illegally” treated differently from

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

209. *Cf. Armstrong*, 517 U.S. at 463–66 (listing the justifications for why the standard to prove selective prosecution is “a demanding one”).

210. *Wayte v. United States*, 470 U.S. 598, 610 (1985). The SEC is entitled to the same standard of review when acting in its prosecutorial capacity as the Department of Justice. *See Fog Cutter Capital Grp. Inc. v. SEC*, 474 F.3d 822, 823, 826–27 (D.C. Cir. 2007) (applying selective prosecution standards from *Armstrong*, a drug prosecution case, to the SEC’s decision not to review whether a company was improperly delisted from the Nasdaq).

211. *See infra* note 275 and accompanying text.

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

213. *Gupta v. SEC*, 796 F. Supp. 2d 503, 513 (S.D.N.Y. 2011); *see also supra* notes 3–4 and accompanying text.

his codefendants was sufficient to allow review of the SEC's choice to bring administrative proceedings prior to an ALJ initial decision.<sup>214</sup>

But Judge Rakoff's decision is quite an outlier, and the language in the case would have permitted the court to reverse itself upon fact-finding (it suggested that an equal protection claim might apply in the context of a motion to dismiss, assuming all the facts alleged by the plaintiff were true).<sup>215</sup> It is very unlikely that other federal judges will follow in Judge Rakoff's wake, and they, as of this decision, have not done so.<sup>216</sup>

### C. *Due Process*

There are three aspects to the due process claims that have been levied against the SEC's ALJ program. One aspect features an argument that routing cases administratively that could have been brought in court—and would have been before passage of the Dodd-Frank Act—to ALJs is constitutionally problematic because it is unfair to those defendants who could have enjoyed a day in court. A second argues that the ALJ program, where agency officials act as judge, jury, and prosecutor, violates the due process rights of defendants. And a third posits that the lack of consent by some defendants to submit themselves to ALJ jurisdiction—they are unlike the traditional, registered SEC ALJ defendant—makes it unfair to subject them to any proceeding other than that before a federal court.

None of these arguments are availing. The Supreme Court has praised the process offered by ALJs in the past, and agencies have been expressly permitted to combine the functions of enforcement and adjudication under one roof.<sup>217</sup> Other agencies have often filed suit against unlicensed defendants and have never been deemed to be violating due process in doing so. The courts have generally rejected these arguments, and appropriately so.

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214. *Gupta*, 796 F. Supp. 2d at 513. Other district courts that have considered this issue have rejected review prior to a final agency decision. *See* *Chau v. SEC*, 72 F. Supp. 3d 417, 431–32 (S.D.N.Y. 2014) (holding that review of the equal protection claim would still be available after the administrative final decision and distinguishing *Gupta* on its facts); *Jarkesy v. SEC*, 48 F. Supp. 3d 32, 40 (D.D.C. 2014) (holding that review of the equal protection claim would be available only on appeal of the agency decision).

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

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

217. *See, e.g., Withrow v. Larkin*, 421 U.S. 35, 55–56 (1975) (holding that it did not violate due process for the SEC to both investigate and adjudicate a case); *Richardson v. Perales*, 402 U.S. 389, 410 (1971) (holding the same with regard to hearing examiners at the Social Security Administration).

1. *Fairness.*—The concern with fairness is exemplified by the collateral proceedings initiated by a Houston hedge fund manager alleged to have steered oversized fees to a brokerage firm CEO. The hedge fund manager sued rather than be faced with an ALJ proceeding because such a proceeding lacks “minimum standards of fairness.”<sup>218</sup>

The check for the process given by an agency is a three-factor balancing test announced in *Mathews v. Eldridge*.<sup>219</sup> The factors to be balanced are first, “the private interest that will be affected by the official action”; second, “the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards”; and third, “the Government’s interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.”<sup>220</sup>

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

Time and again ALJs have been held up as examples of due process. Indeed, many administrative law scholars think that formal adjudication is a rather inefficient system that plays an increasingly unimportant role in agency policymaking because it offers so much process to defendants at some cost to administrative efficiency and bureaucratic rationality.<sup>221</sup>

For its part, the Supreme Court has held that the similarities between adjudication before ALJs and before federal district court judges are “overwhelming”—and no one thinks that federal civil trial practice violates the requirements of due process.<sup>222</sup> The Court has also said that the role of ALJs when presiding over hearings is “functionally comparable” to that of an Article III judge.<sup>223</sup> The SEC’s own Rules of Practice are “similar to the Federal Rules of Civil Procedure,” resulting in hearings “virtually identical to U. S. district court bench trials.”<sup>224</sup> Scholars have agreed.<sup>225</sup>

218. Complaint at 2, *Jarkesy*, 48 F. Supp. 3d 32 (No. 1:14-cv-00114).

219. 424 U.S. 319 (1976).

220. *Id.* at 335.

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

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

223. *Butz v. Economou*, 438 U.S. 478, 513 (1978).

224. Daniel F. Solomon, *Summary of Administrative Law Judge Responsibilities*, 31 J. NAT’L ASS’N ADMIN. L. JUDICIARY 476, 516 (2011).

225. See, e.g., Chris Guthrie et al., *The “Hidden Judiciary”: An Empirical Examination of Executive Branch Justice*, 58 DUKE L.J. 1477, 1482–83 (2009) (“ALJs possess educational and professional credentials comparable to those of generalist judges, and in the courtroom, they perform the same function.” (footnotes omitted)); Harders, *supra* note 202, at 9 (“[T]hose who come before administrative law judges recognize that the deciding of disputes, the prescribing of

The SEC has been offering the process provided by its ALJs since the passage of the APA, and it has never been successfully accused of violating due process for doing so.<sup>226</sup> Indeed, the ALJs in the agency have been held up as a model of process. The Government Accountability Office (GAO) studied the agency's use of ALJs in the 1990s; rather than question the legitimacy of the process offered by them, the GAO suggested that some reforms undertaken by the office might serve as a model for comparable reforms that might be undertaken by comparable agencies.<sup>227</sup>

It is true that there might be some point at which consistently observed practice in enforcement could, if suddenly shifted, create issues of arbitrariness, but such a claim could be brought under the APA itself rather than under the Constitution—and if anything, the Supreme Court has recently indicated its general acceptance of policy shifts made without formal notice.<sup>228</sup>

2. *Combination of Functions.*—The *Wall Street Journal* has weighed in against “The SEC as Prosecutor and Judge,”<sup>229</sup> and the corporate law scholar Stephen Bainbridge has asked “[s]hould the SEC be prosecutor, judge, jury, and executioner?”<sup>230</sup> This sort of argument about admin-

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duties, and the recognition of entitlement affects them in much the same way that litigation plays out in courts of law.”)

226. As the SEC's Enforcement Director recently observed, “we have been using administrative proceedings throughout the 42-year history of the Division of Enforcement, and the Commission used them even before its enforcement activities were consolidated in one division. SEC administrative law judges (ALJs) have adjudicated hundreds of enforcement matters over the years.” See Ceresney, *supra* note 43 (continuing on to assert that “no due process violation” has been found in ALJ cases).

227. In particular, the GAO concluded that the SEC's structuring of its ALJ program might be duplicated by the comparable program run by the CFTC. U.S. GEN. ACCOUNTING OFFICE, ADMINISTRATIVE LAW JUDGES: COMPARISON OF SEC AND CFTC PROGRAMS 1 (1995), <http://www.gao.gov/assets/230/221858.pdf> [<https://perma.cc/39KU-4U5F>]. Congress and the Administrative Conference of the United States mulled over whether to increase the powers of the SEC's ALJs in the 1960s. Emmette S. Redford, *The President and the Regulatory Commissions*, 44 TEXAS L. REV. 288, 316 (1965) (“Reorganization Plans 1 to 5 inclusive and 7 proposed that the SEC, FCC, CAB, FTC, NLRB, and FMC be authorized to delegate final disposition of cases to divisions of the commission or board, to individual members, to hearing examiners, or other employees, subject to review on the vote of one less than a majority of the commission or board.”).

228. In 2015, the Court, in a reversal of the practice of the D.C. Circuit, reversed a requirement that agencies undergo notice-and-comment rulemaking if they sought to change policies that had originally been promulgated without substantive effect. *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, 1203 (2015) (holding that an agency need not “use the APA's notice-and-comment procedures when it wishes to issue a new interpretation of a regulation that deviates significantly from a previously adopted interpretation”).

229. Ryan, *supra* note 12.

230. Stephen Bainbridge, *Should the SEC be Prosecutor, Judge, Jury, and Executioner?*, PROFESSORBAINBRIDGE.COM (Oct. 21, 2014), <http://www.professorbainbridge.com/professorbainbridgecom/2014/10/should-the-sec-be-prosecutor-judge-jury-and-executioner.html> [<https://perma.cc/E969-4CY2>].

istrative adjudicators has a long pedigree, even if, as Bainbridge admits, it has never gone very far in the courts.<sup>231</sup> It is undoubtedly odd that, as Daniel Walfish has observed, SEC commissioners hear appeals from administrative proceedings, “[a]nd yet the Commission is the same body that in the first place decided to prosecute the case.”<sup>232</sup>

The problem with this due process argument, however, lies in *Withrow v. Larkin*,<sup>233</sup> in which the Supreme Court held that in an agency, “the combination of investigative and adjudicative functions does not, without more, constitute a due process violation.”<sup>234</sup> The mere fact that everyone involved in administrative proceedings works for the agency is not enough to imperil the constitutionality of the process followed, even if the agency does not carefully separate those functions on its organizational chart. *Withrow* means that there is no constitutional problem with the agency’s commissioners requiring that enforcement actions be approved by them, even if they know that they may have to sit on appeals of those enforcement actions, as is the case with most agencies with law-enforcement powers (indeed, the facts of *Withrow* covered precisely this issue, with the members of a state board reviewing proceedings brought against a doctor in a case that the board initiated).<sup>235</sup>

But the reasons to be comfortable with a combination of functions in one agency is especially strong in the case of formal adjudications because ALJs have a great deal of statutorily protected independence. By law they cannot, when holding hearings, be supervised by in-house prosecutors, for example, and they enjoy a host of job protections that limit the ability of the agency to monitor their efficiency, let alone interfere with their decisionmaking.<sup>236</sup>

The Supreme Court has already held that the fact that proceedings inside an agency were brought before an administrative law judge suggests that the requirements of due process were satisfied rather than violated.<sup>237</sup>

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231. *Id.* Indeed, the SEC has been criticized for this since its inception. “[T]here is something abhorrent in the idea that any single group may make laws, may act as a public prosecutor in enforcing those laws, and may then determine the guilt or innocence of the person it has accused.” Roland L. Redmond, *The Securities Exchange Act of 1934: An Experiment in Administrative Law*, 47 *YALE L.J.* 622, 636–37 (1938).

232. Walfish, *supra* note 175.

233. 421 U.S. 35 (1975).

234. *Id.* at 58.

235. *Id.* at 46–52.

236. 5 U.S.C. § 554(d) (2012); *see also* SEC Rules of Practice, 17 C.F.R. § 201.121 (2015) (“Any Commission officer, employee or agent engaged in the performance of investigative or prosecutorial functions for the Commission in a proceeding . . . may not, in that proceeding or one that is factually related, participate or advise in the decision . . .”).

237. *See, e.g.,* *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 248–52 (1980) (holding that a civil penalty system permitting payment of fines assessed by an administrative law judge to a federal agency did not violate due process because it was “the administrative law judge, not the

Accordingly, complaining that the odd fact that the SEC brings cases that it then reviews on appeal amounts to a claim of illegality goes against settled precedent.<sup>238</sup>

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

Lawyers who want to turn the issue into a litigatable one might make an analogy to the Supreme Court’s jurisprudence on bankruptcy-court judges. The Supreme Court established in the seminal *Northern Pipeline*<sup>239</sup> case that there is a limit to the powers that can be conferred on an Article I court.<sup>240</sup> The Court held that Congress could not grant upon an Article I court “‘the essential attributes’ of judicial power.”<sup>241</sup> While the “essential attributes” were not explicitly defined, the Court held in *Northern Pipeline* that bankruptcy judges lacked the authority to hear state law counterclaims based on contract and misrepresentation.<sup>242</sup>

The Court fleshed out this holding in *Stern v. Marshall*,<sup>243</sup> where it held that “[w]hen a suit is made of ‘the stuff of the traditional actions at common law tried by the courts at Westminster in 1789’ and is brought within the bounds of federal jurisdiction, the responsibility for deciding that

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[Employment Standards Administration], who performs the function of adjudicating child labor violations”).

238. Walfish has argued, to be sure, that

[a]lthough Congress and the Supreme Court have technically given the governing body at the top of an agency the ability to serve a dual role in authorizing charges and adjudicating them, the SEC Commissioners appear not to be actually using this authority in the way that Congress and the Supreme Court expected when they conferred it.

Walfish, *supra* note 175. But even a close investment in the decision to prosecute and the ultimate review seems to pass constitutional muster, and of course, the ALJs are insulated from agency influence; reversing them is the sort of thing that would get the attention of federal judges on review, too. Giving the Enforcement Division the power to bring cases without a commission sign-off, as Walfish recommends, might be good policy, but is unlikely to be legally required.

239. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

240. *Id.* at 76.

241. *Id.* at 81.

242. *Id.* at 84, 87.

243. 131 S. Ct. 2594 (2011).

suit rests with Article III judges in Article III courts.”<sup>244</sup> In *Stern*, the Court reiterated that bankruptcy judges, regardless of statutory authorization from Congress, lacked the authority to decide common law counterclaims.<sup>245</sup> While the bankruptcy courts only issued preliminary opinions, the Court held that because district courts gave substantial deference to the bankruptcy courts’ findings of fact, the bankruptcy courts could not be considered adjuncts of Article III courts.<sup>246</sup>

At first blush, these bankruptcy holdings seem to have little to do with the SEC’s use of ALJs. Unlike the bankruptcy cases, the SEC administrative proceedings do not involve common law counterclaims, but instead involve purely statutory violations.<sup>247</sup> A civil penalty for a violation of the securities acts is not “a suit . . . made of ‘the stuff . . . tried by the courts at Westminster in 1789.’”<sup>248</sup> Moreover, the securities laws are an area where the SEC has special expertise.<sup>249</sup>

And in practice, many other agencies use ALJs to adjudicate claims that would otherwise come within the jurisdiction of the federal courts. For example, the International Trade Commission uses ALJs to adjudicate allegations of “unfair trade practices”—a term set forth in a statute, but one with common law origins.<sup>250</sup> ITC ALJs have the power to issue exclusion orders that ban products that infringe U.S. patents from being imported into the United States.<sup>251</sup> This sweeping power results in in rem orders that are directed at the infringing products and binding on all parties, including parties outside the United States who are not even aware of the ITC proceeding—in rem remedies also have common law analogies.<sup>252</sup>

The Federal Trade Commission (FTC) uses ALJs to oversee hearings and issue initial decisions in unfair trade practices cases.<sup>253</sup> Similar to the SEC context, FTC ALJs have sweeping authority to issue injunctive relief

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244. *Id.* at 2609 (citation omitted).

245. *Id.* at 2609–10.

246. *Id.* at 2611.

247. See U.S. SEC. & EXCH. COMM’N, RULES OF PRACTICE AND RULES ON FAIR FUND AND DISGORGEMENT PLANS 1 (2006) (defining an enforcement proceeding as “an action . . . held for the purpose of determining whether or not a person is about to violate [or] has violated . . . any statute or rule administered by the Commission”).

248. See *Stern*, 131 S. Ct. at 2609.

249. Cf. *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 865 (1984) (“[A]n agency to which Congress has delegated policymaking responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration’s views of wise policy to inform its judgments.”).

250. See 19 U.S.C. § 1337 (2012) (defining what constitutes “unfair practices in import trade” and establishing the procedures for the ITC’s investigations of violations).

251. *Id.* § 1337(a), (d).

252. See, e.g., Gary M. Hnath, *General Exclusion Orders Under Section 337*, 25 NW. J. INT’L L. & BUS. 349, 351 (2005) (mentioning how general exclusion orders apply to all infringing articles, not only those manufactured, imported, or sold by parties named as respondents).

253. 15 U.S.C. § 45(b) (2012).

against any person “using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce.”<sup>254</sup> The FTC has the power only to order injunctive relief and not money penalties, but these FTC cases can sweep in anyone who violates the antitrust laws, not just regulated entities or those who consent to the agency’s jurisdiction.

The Environmental Protection Agency (EPA) ALJs issue initial decisions to decide alleged violations of a variety of environmental protection statutes.<sup>255</sup> Under the Comprehensive Environmental Response, Compensation, and Liability Act, for example, EPA ALJs may impose penalties of up to \$25,000 per day for failure to comply with EPA orders.<sup>256</sup> These penalties may be imposed regardless of any prior consent to EPA jurisdiction.<sup>257</sup>

But the SEC’s use of ALJs might be—and this is the best doctrinal case against the agency’s authority, even if it is still not particularly strong—different in some ways. It requires analogizing the heavy fines and penalties, and the frequent follow-on nature of the penalties, to something that looks close enough to being part of a criminal case to raise constitutional questions.

It is clear that the Supreme Court’s jurisprudence in cases like *Northern Pipeline* would prevent an administrative agency from hearing criminal cases.<sup>258</sup> The SEC itself does not prosecute criminal violations of the securities laws in federal court, relying instead on the Department of Justice and U.S. Attorney’s offices, though SEC staff may assist on criminal cases.<sup>259</sup> But the SEC follows the criminal proceedings, often closely, with administrative proceedings that are entirely a *fait accompli*, where the only question is what sort of civil punishment will be imposed.<sup>260</sup>

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254. *Id.* And like the SEC, the FTC has been accused of being an impossible venue for respondents. See, e.g., David Balto, *Can the FTC Be a Fair Umpire?*, HILL: CONGRESS BLOG (Aug. 14, 2013, 3:00 PM), <http://thehill.com/blogs/congress-blog/economy-a-budget/316889-can-the-ftc-be-a-fair-umpire> [<https://perma.cc/DD6C-YLH5>] (noting that from 1995 to 2013, the FTC won every case it brought in the administrative forum).

255. See 40 C.F.R. § 22.1 (2015) (listing statutes under which EPA ALJs have authority to issue civil penalties).

256. 42 U.S.C. § 9609 (2012).

257. See *id.* § 9607(a) (imposing liability on owners or parties related to the disposal of hazardous substances).

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

259. See INT’L INST. FOR SEC. MKT. DEV., 2005 PROGRAM 1 (2005), [https://www.sec.gov/about/offices/oia/oia\\_enforce/overviewenfor.pdf](https://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf) [<https://perma.cc/2RNW-ZBXA>] (explaining how the SEC’s Division of Enforcement assists the U.S. Attorneys in criminal securities proceedings).

260. Thomas C. Newkirk & Ira L. Brandriss, U.S. Sec. & Exch. Comm’n, *The Advantages of a Dual System: Parallel Streams of Civil and Criminal Enforcement of the U.S. Securities Laws*, Speech at the 16th International Symposium on Economic Crime, Jesus College, Cambridge, England (Sept. 19, 1998), <https://www.sec.gov/news/speech/speecharchive/1998/spch222.htm> [<https://perma.cc/49D8-YCLS>].

Moreover, the SEC under its current leadership has embraced bringing civil penalty actions in cases that also involve criminal prosecutions.<sup>261</sup>

Of those penalties, disgorgement has particularly broad and sweeping scope. Indeed, while the SEC is statutorily authorized to impose disgorgement,<sup>262</sup> disgorgement is not defined in the statute and therefore is assumed to be contiguous with the equitable remedy previously imposed by Article III courts.<sup>263</sup> Unlike the statutorily defined penalties, which are fixed in amount and clearly defined,<sup>264</sup> disgorgement need only be a “reasonable approximation of” the violator’s wrongful gain.<sup>265</sup>

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

Even this sort of a claim would be fraught with problems. The Supreme Court has made it clear that follow-on civil proceedings for the same conduct that also gives rise to criminal proceedings does not pose an issue of double jeopardy.<sup>266</sup> The Court has also affirmed the ability of an administrative agency, the Office of the Comptroller of the Currency, to impose civil penalties and injunctive relief against the respondents, who were later indicted in federal court on criminal charges.<sup>267</sup>

Despite some sympathy surrounding the degree of consent, and the way that Dodd-Frank has neatly replaced adjudication in federal court with an unfettered ALJ option, it is unlikely that even a consent-based theory of a due process violation, with a bit of separation-of-powers concerns thrown in, would be something sustainable for any defendants—and it certainly could not work for many of them.

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261. See Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, All-Encompassing Enforcement: The Robust Use of Civil and Criminal Actions to Police the Markets (Mar. 31, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370541342996> [<https://perma.cc/93YQ-SEMQ>] (highlighting how the SEC often brings actions parallel to those brought by criminal authorities).

262. 15 U.S.C. § 77h-1(e) (2012).

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

264. 15 U.S.C. § 77h-1(g)(2).

265. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996).

266. *Hudson v. United States*, 522 U.S. 93, 95–96 (1997).

267. *Id.* at 96–98.

#### D. Right to a Jury

The Seventh Amendment provides that “[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved.”<sup>268</sup> But proceedings before ALJs do not feature a jury; some defendants have argued that their jury-trial right has accordingly been violated.<sup>269</sup>

The problem with the jury-trial argument is that it only applies to “Suits at common law,” and the SEC’s administrative proceedings, designed to protect investors in kinds of markets that did not exist at the time of the framing of the Constitution, are not those kinds of suits.<sup>270</sup> As the Supreme Court said in *Atlas Roofing Co. v. Occupational Safety and Health Review Commission*,<sup>271</sup> “when Congress creates new statutory ‘public rights,’ it may assign their adjudication to an administrative agency with which a jury trial would be incompatible, without violating the Seventh Amendment’s injunction that jury trial is to be ‘preserved’ in ‘suits at common law.’”<sup>272</sup> It could hardly, of course, be otherwise, lest every tax dispute, EPA fine, or national park camping permit fight require the making of a federal case.<sup>273</sup> *Atlas Roofing* involved a civil penalty; the SEC’s civil penalty regime is similar, and so should pass constitutional muster.<sup>274</sup> The other remedies offered by the agency—cease-and-desist orders, industry bans, and likely also disgorgement, though that is a modestly closer call—present even more straightforward claims, because they look more like equitable remedies than the sorts of damages remedies that look like common law relief.<sup>275</sup>

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268. U.S. CONST. amend. VII.

269. See, e.g., Phyllis L. Skupien, *Former CEO Says SEC Administrative Proceedings Are Unconstitutional*, WESTLAW J. SEC. LITIG. & REG., Jan. 22, 2015, at \*1 (mentioning a former CEO’s suit against the SEC for infringing her constitutional right to a jury trial).

270. See *Hill v. SEC*, 114 F. Supp. 3d 1297, 1315–16 (N.D. Ga. 2015) (ruling that the Seventh Amendment jury-trial right does not apply to SEC administrative proceedings).

271. 430 U.S. 442 (1977).

272. *Id.* at 455.

273. As the Supreme Court has observed. *E.g., id.* at 450–52 (mentioning tax, immigration, and rent-control cases in which the Court allowed Congress to give administrative agencies the power to decide whether violations occurred); *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 48–49 (1937) (rejecting a jury-trial claim under the National Labor Relations Act); *Wickwire v. Reinecke*, 275 U.S. 101, 105–06 (1927) (noting that Congress need not offer a jury trial for cases involving tax evasion).

274. *Atlas Roofing*, 430 U.S. at 444; see also 2 FEDERAL PROCEDURE, LAWYER’S EDITION § 2:11, Westlaw (West 2015) (“The right to a jury trial in suits at common law preserved by the Seventh Amendment is inapplicable in administrative proceedings.”).

275. The Supreme Court has occasionally suggested that such an analysis might limit the ability of agencies to take on any sort of justiciable claim. See *Tull v. United States*, 481 U.S. 412, 417–18 (1987) (noting that the nature of the remedy sought affects the determination of the statutory action as legal or equitable action).

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

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

The first of these doctrines holds that agencies, as a general matter, have discretion to choose between various enforcement mechanisms provided by Congress.<sup>276</sup> Accordingly, the SEC may choose to pursue civil remedies in addition to criminal remedies pursued by the Department of Justice—the fact that a criminal case has been filed does not mean that the agency cannot bring follow-on proceedings to its ALJs.<sup>277</sup>

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

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

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276. See *Heckler v. Chaney*, 470 U.S. 821, 838 (1985) (holding that agency “refusals to institute investigative or enforcement proceedings” are committed to agency discretion); *Moog Indus., Inc. v. FTC*, 355 U.S. 411, 413–14 (1958) (per curiam) (holding that the FTC’s decision to proceed against some but not all members of an alleged cartel was committed to agency discretion).

277. See *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1377 (D.C. Cir. 1980) (en banc) (“Effective enforcement of the securities laws requires that the SEC and Justice be able to investigate possible violations simultaneously.”).

278. Compare 15 U.S.C. § 78u-3(a) (2012) (authorizing cease-and-desist proceedings before ALJs), with 15 U.S.C. § 78u-1(a)(1)(a) (authorizing a civil action in district court).

279. See, e.g., S. REP. NO. 101-337, at 17–18 (1990) (describing the new cease-and-desist power as an “alternative” to district court litigation given the SEC flexibility to choose between fora).

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

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

#### F. Timing Problems

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

Because the SEC has not completed its enforcement action before suit has been filed—the cases generally sit before the Enforcement Division or have been filed before ALJs, but have not resulted in an appeal and final decision by the Commission—judicial claims against the agency must first make the case that they need not wait until the agency action is final,

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280. U.S. SEC. & EXCH. COMM’N, *supra* note 101, at 1–3.

281. 332 U.S. 194 (1947).

282. *Id.* at 203 (“[T]he choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency.”).

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

284. *See, e.g.*, *Chau v. SEC*, 72 F. Supp. 3d 417, 425 (S.D.N.Y. 2014) (“This Court’s jurisdiction is not an escape hatch for litigants to delay or derail an administrative action when statutory channels of review are entirely adequate.”); *see also 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).

ordinarily a constraint in administrative law.<sup>285</sup> Litigating over the propriety of unresolved agency claims also poses ripeness problems, in that the issues might not yet be “fit for judicial resolution,” again because the agency has more to do.<sup>286</sup> The idea is that a court should not hear constitutional issues when they might not have to do so; the constitutional claims could be resolved in favor of the plaintiffs by the SEC, or it could dismiss the case for other reasons, making judicial involvement unnecessary.

By the same token, immediate judicial review raises exhaustion issues; plaintiffs aggrieved that the agency intends to, or is, suing them before agency ALJs have not given the agency or the ALJs the opportunity to evaluate their claims before they are being litigated in district court.<sup>287</sup> Exhaustion is not required unless specifically authorized by agency rule or governing statute; the Exchange Act provides that a “person aggrieved” by a final SEC order “may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business,” which does not by plain language mandate exhaustion.<sup>288</sup> However, the agency has characterized its remedial scheme as exclusive, meaning that it has argued that plaintiffs must avail themselves of appeal to the agency and then to the court of appeals, and the courts have therefore generally required exhaustion.<sup>289</sup>

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285. See *FTC v. Standard Oil Co. of Cal.*, 449 U.S. 232, 243 (1980) (noting plaintiff’s argument that it had exhausted its administrative remedies before holding that the agency’s decision to launch an investigation was not “final agency action” suitable for judicial review).

286. See *Abbott Labs. v. Gardner*, 387 U.S. 136, 148–49, 153 (1967) (setting forth the ripeness test). Ripeness is assessed by balancing the fitness of the issues for resolution against the hardship to the plaintiff in withholding review. *Id.* at 149. That second factor, of course, might mitigate against a ripeness finding, but the first factor, given that the agency has not completed its enforcement actions in these cases, points in the other direction.

287. One possible reason not to require exhaustion is raised by the fact that one cannot raise counterclaims against the SEC before its administrative law judges. See Jeffrey L. Feldman, Admin. Proc. File No. 3-8063, SEC Release No. 403, 55 SEC Docket 2477, 2478 (ALJ Jan. 14, 1994) (dismissing respondent’s counterclaim because “[t]he Commission’s Rules of Practice do not provide for a counterclaim”). But ALJs can of course entertain defenses, including affirmative defenses, and the claim that the process is unconstitutional would seem to be such a defense.

288. 15 U.S.C. § 78y(a)(1) (2012). The courts have generally required litigants to exhaust their administrative remedies before proceeding to court to interrupt proceedings. See *SEC v. R.A. Holman & Co.*, 323 F.2d 284, 287 (D.C. Cir. 1963) (“The administrative proceedings cannot be stopped to allow for excursions in the courts with prolonged evidentiary hearings; the time for that in a proper case is when an aggrieved litigant seeks judicial review of agency action having preserved the point of claimed disqualification in the administrative hearing.”).

289. And the Second Circuit has agreed, deciding that this provision for review “generally preclude[s] *de novo* review in the district courts, requiring litigants to bring challenges ‘in the Court of Appeals or not at all.’” *Altman v. SEC*, 687 F.3d 44, 45–46 (2d Cir. 2012) (quoting *City of Tacoma v. Taxpayers of Tacoma*, 357 U.S. 320, 336 (1958)); see also *Touche Ross & Co. v. SEC*, 609 F.2d 570, 574–75 (2d Cir. 1979) (holding that the claim that the SEC tribunal was biased must first be presented in an administrative forum rather than in collateral attack in district court).

All of these problems, which are designed to promote judicial efficiency, could be recast to question whether hearing the matter would run afoul of the Constitution's "case or controversy" requirement. Federal judges may only hear cases in which the plaintiff has standing, that is, has suffered a concrete injury attributable to the defendant, and the decision to institute enforcement proceedings, as opposed to imposing a sanction, against the petitioners might not be a sufficiently concrete harm.

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

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

The Court believed all of these requirements were satisfied in *Free Enterprise Fund*. The Court noted that the Appointments Clause challenge was outside the agency's expertise, instead posing only "standard questions of administrative law, which the courts are at no disadvantage in

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290. As one judge has observed, district court jurisdiction "is not an escape hatch for litigants to delay or derail an administrative action when statutory channels of review are entirely adequate." *Chau v. SEC*, 72 F. Supp. 3d 417, 425 (S.D.N.Y. 2014); *see also Bebo v. SEC*, Fed. Sec. L. Rep. (CCH) ¶ 98,385, 94,133, 94,136 (E.D. Wis. Mar. 3, 2015) ("If the process is constitutionally defective, [plaintiff] can obtain relief before the Commission, if not the court of appeals.").

291. *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 490–91 (2010).

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

293. *Id.* at 487.

294. 510 U.S. 200 (1994).

295. *Id.* at 204–05.

296. *Id.* at 212, 216.

297. *Id.* at 212–13.

answering.”<sup>298</sup> In addition, the Court held that the plaintiffs could not obtain meaningful review without incurring “a sizeable fine.”<sup>299</sup> This was enough for the Court to find review appropriate without waiting for a final agency decision.<sup>300</sup>

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

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

### G. Conclusion

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

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

299. *Id.* at 490–91.

300. *Id.* at 491.

301. See, e.g., Gray Financial Complaint, *supra* note 10, at 26 (arguing that the court should not allow the SEC proceeding to continue while the federal complaint is pending because of the high monetary costs that would be incurred).

302. *Id.* at 1–2. But the strength of the argument that ALJs violate the Appointments Clause is dubious. See *supra* subpart II(A).

303. See, e.g., *Chau v. SEC*, 72 F. Supp. 3d 417, 429–30 (S.D.N.Y. 2014) (rejecting an attempt by the plaintiff to fit a pre-enforcement due process challenge into the *Free Enterprise Fund* framework).

304. See Paul R. Verkuil, *Reflections Upon the Federal Administrative Judiciary*, 39 UCLA L. REV. 1341, 1362–63 (1992) (comparing the hypothetical use of ALJs in disability, immigration, and other contexts). Immigrants get adjudications that feature less process than formal adjudications under the APA, but that still look like trial-type proceedings. See Michele Benedetto, *Crisis on the Immigration Bench: An Ethical Perspective*, 73 BROOK. L. REV. 467, 468–70 (2008) (chronicling the “widespread problem[s]” in the immigration adjudication process); Stephen H. Legomsky, *Learning to Live with Unequal Justice: Asylum and the Limits to*

The right way to handle the claims against the SEC's enforcement policy is to treat them like any other question of administrative law, and judge each claim based—at most—on its reasonableness.<sup>305</sup> The question could be asked in the following way: is the decision to route more cases to in-house ALJs either committed to agency discretion as a choice of policymaking form, or a reasonable interpretation of Congress's statutory command? Answering the question is straightforward enough. In either case, the SEC's approach would be affirmed.

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

If the SEC's policy on when it might route cases to ALJs was itself subject to some sort of review, assuming it could somehow be characterized as agency action sufficiently definite as to be susceptible to judicial review,<sup>308</sup> the question would turn on whether the decision to entertain the use of ALJs more often was inconsistent with a reasonable interpretation of Dodd-Frank's provisions expanding ALJ jurisdiction.<sup>309</sup> It would be straightforward to conclude that it is, as the very purpose of the expansion of ALJ jurisdiction was to provide more enforcement options to the agency.

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

This part of the Article argues that the disjunction between the deeply held beliefs of the corporate bar that administrative proceedings are unfair and the realities of current administrative law doctrine can tell us something interesting about what corporate lawyers expect from the courts—namely,

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*Consistency*, 60 STAN. L. REV. 413, 444–73 (2007) (discussing a variety of reforms designed to improve the system of administrative adjudication).

305. Zaring, *supra* note 63, at 140 (arguing that most standards of review in administrative law are based on a reasonableness calculation).

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

307. *SEC v. Chenery Corp.*, 332 U.S. 194, 202–03 (1947) (“[T]he choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency.”).

308. 5 U.S.C. § 704 (2012) (providing that policy statements are not subject to judicial review).

309. *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844–45 (1984) (setting forth the reasonableness test).

equity. In an era when much of corporate scholarship is concerned with the efficiency of various doctrines and SEC rules, the preference of corporate litigators is worth remembering.

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

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

In addition, trial court judges in Manhattan have taken up this equitable role. The judges, often experienced with white-collar prosecutions, will occasionally discipline the government, not necessarily for violating the law but for going too far in a particular case. For example, Judge Lewis Kaplan harshly criticized the government's efforts to prevent an accounting firm from paying the attorneys' fees of its employees as a transgression of the obligation to permit defendants to mount a defense.<sup>314</sup>

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310. Frank v. Elgamal, No. 6120, 2014 WL 957550, at \*20 (Del. Ch. Mar. 10, 2014).

311. See, e.g., *In re Rural Metro Corp.*, 88 A.3d 54, 100 (Del. Ch. 2014) (faulting an investment bank that “never disclosed to the Board its continued interest in buy-side financing and plans to engage in last minute lobbying”); *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432, 442–45 (Del. Ch. 2012) (finding a possible conflict when an investment bank had a personal stake in facilitating a merger, rather than in getting the best price for shareholders); *In re Del Monte Foods Co. S’holders Litig.*, 25 A.3d 813, 836 (Del. Ch. 2011) (finding a conflict when advising the sell side and offering financing to the buy side).

312. See Rock, *supra* note 23, at 1016 (claiming that the “Delaware courts generate in the first instance the legal standards of conduct . . . largely through what can best be thought of as ‘corporate law sermons’”).

313. William J. Carney, *The Background of Modern American Business Law 2* (2015) (unpublished manuscript) (on file with the Texas Law Review).

314. Judge Kaplan stated:

KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not been brought to bear, KPMG would have paid these defendants' legal expenses. Those who commit crimes—regardless of whether they

Judge Jed Rakoff, who spent seven years as a federal prosecutor in Manhattan, culminating in a stint as the Chief of the Business and Securities Fraud Prosecutions Unit of the U.S. Attorney's Office there, has played a similar role.<sup>315</sup> He started what became a nationwide campaign against “neither admit nor deny” settlements in the wake of the financial crisis,<sup>316</sup> and, as we have seen, scotched an SEC effort to route its insider trading claims against Rajat Gupta towards the in-house administrative law judges.<sup>317</sup>

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

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wear white or blue collars—must be brought to justice. The government, however, has let its zeal get in the way of its judgment. It has violated the Constitution it is sworn to defend.

*United States v. Stein*, 435 F. Supp. 2d 330, 336 (S.D.N.Y. 2006), *aff'd*, 541 F.3d 130 (2d Cir. 2008).

315. *Jed Rakoff*, COLUM. L. SCH., [http://www.law.columbia.edu/fac/Jed\\_Rakoff](http://www.law.columbia.edu/fac/Jed_Rakoff) [https://perma.cc/YY8Q-FK3F].

316. *See SEC v. Citigroup Glob. Mkts., Inc.*, 827 F. Supp. 2d 328, 333 (S.D.N.Y. 2011), *vacated and remanded*, 752 F.3d 285 (2d Cir. 2014) (“[A]n allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect.”).

317. *See supra* notes 213–16 for a discussion of the case.

318. 773 F.3d 438 (2d Cir. 2014).

319. *See id.* at 448 (“[W]e find no support for the Government’s contention that knowledge of a breach of the duty of confidentiality without knowledge of the personal benefit is sufficient to impose criminal liability.”).

320. *Id.* at 447–48 (“[E]ven in the presence of a tipper’s breach, a tippee is liable only if he knows or should have known of the breach. . . . [W]ithout establishing that the tippee knows of the personal benefit received by [the tipper], the Government cannot meet its burden of showing that the tippee knew of a breach.”).

321. *See* Joan MacLeod Heminway, *Was Martha Stewart Targeted?*, in *MARTHA STEWART’S LEGAL TROUBLES* 3, 3–5 (Joan MacLeod Heminway ed., 2007) (describing Martha Stewart’s case and using it as an example to explain the basic structure of insider trading regulation and enforcement as well as possible sources of selective enforcement bias).

eventually interpreted by the Second Circuit to have been abusively interpreted by the federal prosecutors.<sup>322</sup>

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

In the case of SEC ALJs, there have been complaints that “[t]he judges’ mind-set reflects the agenda of the agency, which in this arena is enforcement,”<sup>324</sup> that the work product of the adjudicators “ooze[s] parochialism and tunnel vision, again showing the administrative forum is no place for enforcement actions of . . . magnitude,”<sup>325</sup> and that there is a “record of utter deference to the agency.”<sup>326</sup> The corporate bar has worried not only that it is unlikely to win before administrative judges, but that the judges are unlikely to police the agency for overdoing it.<sup>327</sup>

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

In administrative law, the D.C. Circuit, which specializes in the subject, certainly could make these sorts of pronouncements, but it does not chastise agencies for going too far provided that they have stayed within the

322. *Newman*, 773 F.3d at 447–48. Nor was *Newman* alone. The government’s lead prosecutor, “one of the most acclaimed prosecutors of his generation, is locked in what seems to be an escalating war of words with the federal judiciary,” facing a series of adverse rulings and judicial reprimands. James B. Stewart, *Some Fear Fallout from Preet Bharara’s Tension with Judges*, N.Y. TIMES (Apr. 16, 2015), <http://www.nytimes.com/2015/04/17/business/preet-bharara-and-federal-judges-trade-barbs-and-some-fear-consequences.html> [<https://perma.cc/M8W4-L6TG>].

323. See *SEC v. Citigroup Glob. Mkts., Inc.*, 752 F.3d 285, 298 (2d. Cir. 2014) (vacating and remanding the lower court decision in this case, as discussed above).

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

325. *SEC ALJ in Bebo Case Refuses to Consider Constitutional Challenge and Denies More Time to Prepare Defense*, SEC. DIARY (Apr. 8, 2015), <http://securitiesdiary.com/2015/04/08/sec-alj-in-bebo-case-refuses-to-consider-constitutional-challenge-and-denies-more-time-to-prepare-defense> [<https://perma.cc/K7NS-EDZK>].

326. Eaglesham, *supra* note 61 (internal quotation marks omitted) (quoting an agency appeal).

327. See, for example, this profile of relatively new ALJ Cameron Elliot, Sarah N. Lynch, *SEC Judge Who Took on the ‘Big Four’ Known for Bold Moves*, REUTERS (Feb. 3, 2014, 10:08 AM), <http://www.reuters.com/article/2014/02/03/us-sec-china-elliott-idUSBREA1107P20140203> [<https://perma.cc/3TER-QLNT>] (“Defense attorneys say Elliot is viewed as being sympathetic to the agency’s enforcement division.”).

letter of their powers. Instead, that court either invokes procedural requirements to reverse rules or defers to agencies when it looks like they have appropriately met their process obligations.

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

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

Whatever the doctrine of administrative law applied to agency policymaking, and whether one believes that it has been applied honestly or not, the restraints offered by judges are not couched in equitable claims of best practices, fairness, and obligation. To be sure, pursuant to *Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co.*,<sup>334</sup> courts are required to take a hard look at agency action before affirming it.<sup>335</sup> A hard look sounds like a pretty principles-based, equitable-

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328. See *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1146–47 (D.C. Cir. 2011) (vacating the SEC's promulgated Rule 14a-11, which increased access to proxy contests).

329. See *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 167, 171, 179 (D.C. Cir. 2010) (vacating the SEC's promulgated Rule 151A, which declared that fixed annuities were not annuity contracts within the meaning of the Securities Act).

330. See *Chamber of Commerce v. SEC*, 412 F.3d 133, 136, 144 (D.C. Cir. 2005) (finding that the SEC violated its statutory duty under the APA in promulgating a new rule regarding mutual funds).

331. *Bus. Roundtable*, 647 F.3d at 1154–56; *Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 167, 171, 179; *Chamber of Commerce*, 412 F.3d at 136, 144.

332. *Chamber of Commerce*, 412 F.3d at 143–44.

333. *Bus. Roundtable*, 647 F.3d at 1149.

334. 463 U.S. 29 (1983).

335. *Id.* at 43. As Catherine Sharkey has explained, under . . . hard-look review, the reviewing court examines the administrative record and the agency's explanation to determine whether the agency (1) relied on factors Congress did not intend it to consider, (2) entirely failed to consider an important aspect of the problem, (3) offered an explanation that runs counter to evidence before

like inquiry, but in practice it is largely concerned with getting the agency to explain why it made the choice it did. As Judge Rakoff's brother, Todd Rakoff, has argued in an article written with now-Judge David Barron, "State Farm . . . favor[s] a requirement that the agency explain itself."<sup>336</sup>

When it comes to administrative law, the courts do not regulate agencies on the basis of broad equitable principles.<sup>337</sup> Instead they apply, cynically or not, the procedural requirements of the APA and review or undo policies on that basis.

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

Indeed, ALJs perform this function as part of the agency, subordinates to their commissioners. Congress considered and rejected the possibility that the adjudicators could be given the independence that might permit sweeping equitable reviews of agency policy when it chose to locate appeals from ALJ decisions to the agency heads for whom they work, rather than to a centralized panel of administrative adjudicators.<sup>338</sup> The APA very explicitly provides that "on appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision."<sup>339</sup> In doing so it has embraced the idea that the policy decisions are for the agency heads, not the ALJs. The thought was that it would, in the words of one ALJ, make clear that ALJs "act on behalf of those agencies," and that therefore "they are often expected to help achieve

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the agency, or (4) is so implausible that it could not be ascribed to the product of agency expertise.

Catherine M. Sharkey, *State Farm "With Teeth": Heightened Judicial Review in the Absence of Executive Oversight*, 89 N.Y.U. L. REV. 1589, 1609 (2014).

336. David J. Barron & Todd D. Rakoff, *In Defense of Big Waiver*, 113 COLUM. L. REV. 265, 330 (2013).

337. Or, at least, they do not do so ordinarily. In *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000), the Court refused to permit the FDA to regulate cigarettes, even though it had an exceedingly plausible textual argument that its government statute permitted it to regulate drugs (nicotine is a drug) and drug-delivery devices (cigarettes deliver nicotine to the body) because the jurisdictional expansion would be enormous. *See id.* at 127, 160–61. As the Court put it, "[g]iven this history and the breadth of the authority that the FDA has asserted, we are obliged to defer not to the agency's expansive construction of the statute, but to Congress' consistent judgment to deny the FDA this power." *Id.* at 160.

338. For a review of this history, see James E. Moliterno, *The Administrative Judiciary's Independence Myth*, 41 WAKE FOREST L. REV. 1191, 1227 (2006).

339. 5 U.S.C. § 557(b) (2012). In this way, the APA has emphasized that the policy decisions are for the agency heads, not the ALJs.

agency objectives.”<sup>340</sup> That, in turn, makes the agency action filtered through adjudicators ultimately the responsibility of the agency’s politically accountable commissioners.<sup>341</sup>

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

Accordingly, despite their doctrinal missteps, it is surely true that the corporate bar critics are onto something. Judge Rakoff suspects ALJs of being susceptible to a “narrow, tunnel-vision view of the law.”<sup>342</sup> Much of the work of ALJs *is* routine, although there is no indication that they are not independent (perhaps to indicate his independence, one SEC ALJ has announced that he will apply the *Newman* rule to his insider trading cases—despite the fact that his agency believes *Newman* to have been wrongly decided<sup>343</sup>). But since Dodd-Frank, ALJs have taken no grand stands, with the possible exception of the later-reversed decision to throw out an agency

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

341. And there are good reasons for this. See Jim Rossi, *Final, But Often Fallible: Recognizing Problems with ALJ Finality*, 56 ADMIN. L. REV. 53, 64 (2004) (“Since most ALJs operate as merit appointees—and are not subject to the same political accountability constraints as agency heads—the result of ALJ final order authority on issues of law and policy is less political accountability for agency decision-making. ALJ finality also values generalist decision-making over expert-based decision-making, and thus comes at some cost for expertise in agency decision-making.”).

342. Stephanie Russell-Kraft, *Rakoff Continues Crusade Against SEC Admin Courts*, LAW360 (Nov. 21, 2014, 1:46 PM), <http://www.law360.com/articles/598561/rakoff-continues-crusade-against-sec-admin-courts> [<https://perma.cc/2QBH-BUBJ>] (reporting on Rakoff’s remarks at a panel at Columbia Law School).

343. “I am going to follow *Newman* dicta,” [ALJ] Patil said at the end of [a preliminary] hearing” in an insider trading case involving an analyst and a trader (both of whom would like to be registered with the SEC). Stephanie Russell-Kraft, *SEC Admin Judge Will Apply Newman To Insider Trading Case*, LAW360 (Feb. 11, 2015, 7:18 PM), <http://www.law360.com/articles/620709/sec-admin-judge-will-apply-newman-to-insider-trading-case> [<https://perma.cc/Y9S5-PAPJ>]. Of course, the indictment certainly works well for those who would like to chasten regulators before they try to regulate.

effort to bring a financial-crisis case against State Street's sellers of packaged debt obligations, and it is difficult to imagine an ALJ deeming such a stand to be something that belongs in their toolkit.<sup>344</sup>

### Conclusion

The SEC's ALJ program has aroused a great deal of consternation in the corporate law community because of a not-unjustified belief that administrative proceedings are less likely to turn on the sort of equitable considerations that animate, on occasion, judges who sit on courts to cut back on what they perceive as particularly aggressive law enforcement against corporate defendants. That does not make the SEC's decision to route more proceedings to its ALJs illegal; the idea that SEC ALJs must have a record of equitable relief is not required by doctrine and may not be consistent with the facts of ALJ adjudication, where the agency does not always win. It is, however, a telling example of how corporate and administrative lawyers view the methods and ends of adjudication differently. As corporate law becomes ever more regulatory, its legal community will have to come to terms with a different vision of what tribunals are for—or it will have to find some new converts.

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344. *See supra* notes 146–47147 and accompanying text.

**Appendix: Logistic Regression Estimates**

	(1)	(2)	(3)	(4)	(5)	(6)
<b>Representation</b>						
Pro se	-2.98***			-3.08***	-1.76**	-1.67*
Contested	-3.61***			-3.67***	-3.33***	-3.24***
<b>Judges</b>						
Foelak		0.198		0.01		0.41
Grimes		1.18		0.81		0.49
Mahony		-1.12*		-0.38		-0.74
Murray		-0.42		-0.21		-1.01*
Patil		0.30		-1.42		-1.11
<b>Section</b>						
12(j)			4.58***		3.20**	3.71***
15(b)			1.88		0.63	0.87
203(f)			1.66		0.44	0.66
21C			2.08		-0.14	-0.29
Constant	4.31***	2.00***	-0.69	4.63***	2.64*	2.46

NOTE.—No representation is the default for representation type. Elliot is the default for judges. 4C is the default for section. Sections 12(g), 13(a), and 8A are removed from estimation due to 100% SEC win percentage. Asterisks refer to individual coefficient significance with 10% as \*, 5% as \*\*, and 1% as \*\*\*. Testing for joint significance of judge coefficients using the likelihood ratio test on the partial model fails to reject the null in any regression specification. Likelihood ratio tests performed on representation type and section are always significant at 1% where applicable.