# ARTICLES

# FAIR OR FOUL?: SEC ADMINISTRATIVE PROCEEDINGS AND PROSPECTS FOR REFORM THROUGH REMOVAL LEGISLATION

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*The staff of the U.S. Securities and Exchange Commission (SEC or "the Commission") ignited a firestorm when it announced plans to shift litigation from federal courts to its internal administrative proceedings. Critics complain that the SEC's administrative proceedings are fundamentally unfair and give the agency a "home-court" advantage. They complain of discovery restrictions, the rapid pace at which hearings proceed, the admissibility of hearsay testimony, the absence of juries, the fact that administrative law judges (ALJs) and the Commission's enforcement division are all paid by the Commission, the fact that appeals from ALJ rulings are initially to the Commission that initiated the proceeding, and myriad other procedural critiques. Critics also observe that the Commission's insistence on* Chevron *deference to its administrative decisions, combined with this shift to administrative proceedings, could, over time, dramatically reduce the federal judiciary's role in the interpretation of the federal securities laws.*

*This Article catalogues the long list of criticisms of the Commission's administrative proceedings. It also evaluates data describing the outcome of litigated matters and finds that, with the exception of insider trading cases, the Commission has an exceptionally high and statistically indistinguishable record of success in administrative and federal court proceedings alike. The data thus seem not to support the view that the Commission has a generalized home-court advantage in administrative proceedings. Nonetheless, the Commission's virtually unfettered discretion in forum selection decisions, when it can assign cases to a forum that it controls, raises a plethora of institutional design concerns.*

*While legislation designed to cut back dramatically on the number of proceedings litigated in the administrative forum has been introduced in Congress, this Article suggests that a more nuanced policy response may be appropriate. Cases litigated by the SEC can be divided into three*

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*categories. Some, such as insider trading matters, are better resolved in federal court and can be presumptively assigned to that forum unless the defendant consents to an administrative proceeding. Others, such as late filing cases, raise technical issues that can be presumptively assigned to the administrative forum. The third category, composed of cases that fit neither presumptive category, could proceed in the administrative forum subject to a respondent's right to petition for discretionary removal to federal court following a procedure modeled on Federal Rule of Civil Procedure 23(f). The federal judiciary would thus be able to act as a monitor, controlling the SEC's exercise of discretion in its forum selection decisions and providing respondents with a means to challenge those determinations. Indeed, in this capacity, federal court review would create new institutional incentives that could induce the Commission to modernize its internal procedures so that federal courts would be more likely to perceive those procedures as providing a fair and efficient forum for the resolution of the Commission's complaints.*

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## INTRODUCTION

The U.S. Securities and Exchange Commission (SEC or "the Commission") often can choose between two forums when it files enforcement actions.[1] One option is to sue in federal district court, where

1. *See, e.g.*, Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2016 WL 4191191, at *2 (D.C. Cir. Aug. 9, 2016) ("The Commission has authority to pursue alleged violators of the securities laws by filing a civil suit in the federal district court or by instituting a civil administrative action."); SEC, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS 1 (2015), http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf ("The Commission generally is authorized to bring its enforcement actions in either of two forums—a civil action in federal district court or a Commission administrative proceeding (and/or cease-and-desist proceeding) before an Administrative Law Judge—though it has authority to proceed on certain charges or remedies in only one of those forums.") [https://perma.cc/A7YQ-3464]; Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAW. 1, 3 (2015) ("After an investigation reveals a securities law violation, the SEC can refer a matter to the U.S. Department of Justice (DOJ) for consideration of criminal charges, file a civil lawsuit in federal district court, or commence an [administrative proceeding]."). For a discussion of situations in which the Commission must bring its actions as administrative proceedings or in federal court, see *infra* notes 2 and 4. For a discussion of the effects of section 929(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act"), which expands the scope of remedies available to the Commission in its administrative proceedings, see *infra* note 11 and accompanying text.

defendants have a right to a jury trial, can take depositions, and testimony is subject to the Federal Rules of Evidence.[2] Federal district court judges are nominated by the President and confirmed by the U.S. Senate.[3] They are independent of the Commission.

Alternatively, the Commission can file an administrative proceeding that is heard by an administrative law judge (ALJ). There is no right to a jury trial in an administrative proceeding.[4] Discovery is severely restricted, depositions are limited, hearings proceed on a schedule that is far more rapid than in most federal trials, and the Federal Rules of Evidence do not apply.[5] Prosecutors and ALJs in administrative proceedings are all Commission employees.[6] Initial appeals from ALJ rulings are to the Commission itself, the same body that issued the order instituting the proceeding. The Commission review of an ALJ's decision is de novo. Thus, the Commission has the ability to both increase and decrease the sanctions imposed by the ALJ, in addition to the ability to reverse the ALJ's decision.[7] Only after the Commission rules on the appeal does a respondent

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2. In some instances, the Commission must seek relief in federal court because no effective remedy is available through the administrative process. For example, if the Commission seeks prejudgment relief in the form of a temporary restraining order or an order freezing assets, the Commission must resort to federal court because administrative law judges (ALJs) lack the authority to issue such orders. Andrew Ceresney, Dir., SEC Div. of Enf't, Keynote Speech at New York City Bar 4th Annual White Collar Institute (May 12, 2015) [hereinafter Ceresney, Keynote Speech], https://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html [https://perma.cc/LG9X-SKTS]. "[L]iability as a controlling person or as a relief defendant can [also] only be pursued in district court actions." *Id.*

3. U.S. CONST. art. II, § 2, cl. 2 (stating that the President "shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States").

4. Some statutes require an administrative hearing before an ALJ. *See, e.g.*, 15 U.S.C. § 78l(j) (2012) (discussing proceedings to suspend or terminate the registration of public companies for failure to file periodic reports); *id.* § 78o(b)(4) (stating that follow-on proceedings to bar persons or entities from the securities industry must be pursued administratively). "Charges of failure to supervise or" of "causing another person's violation" of the securities laws "can only be pursued in the administrative forum." Ceresney, Keynote Speech, *supra* note 2. The SEC has used administrative proceedings as an alternative to federal court litigation since the SEC's inception. *See, e.g.*, Securities Exchange Act of 1934, Pub. L. No. 73-291, § 4, 48 Stat. 881, 885 (codified as amended at 15 U.S.C. 78a–78pp) (creating the U.S. Securities and Exchange Commission); *id.* §§ 19(a), 22, 48 Stat. at 898, 901 (codified as amended at 15 U.S.C. § 78d) (authorizing the Commission to deny, suspend, or withdraw registrations "after appropriate notice and opportunity for hearing"); Andrew Ceresney, Dir., SEC Div. of Enf't, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014) [hereinafter Ceresney, Remarks to the ABA], https://www.sec.gov/News/Speech/Detail/Speech/1370543515297 (noting that the SEC has "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") [https://perma.cc/3JLL-U9AB].

5. For a detailed discussion of the differences between federal court procedures and procedures in administrative proceedings, see *infra* Part I.

6. For critiques of the ALJ's independence and competence, see *infra* Part I.

7. *See, e.g.*, Aesoph, Exchange Act Release No. 78490, 2016 WL 4176930 (Aug. 5, 2016). The Commission imposed bans on the right to appear or practice before the Commission with a right to requalify in three years and two years, respectively; whereas the

gain the right to be heard by a federal judge unaffiliated with the Commission—a step that requires an appeal from the Commission's ruling to a federal circuit court of appeals.[8] The Commission is hardly alone in its administration of an internal judicial system; many other federal agencies operate similar adjudicatory bodies in which respondents' rights materially diverge from the rights available in federal court proceedings.[9]

The debate over the fairness of the Commission's administrative procedures, and over the discretion the Commission exercises when allocating litigation between federal and administrative venues, ran at a low simmer for decades with only occasional outbursts.[10] However, this relative calm ended in 2013, when the Commission's staff announced plans to rely on expanded administrative remedies created by the Dodd-Frank Wall Street Reform and Consumer Protection Act[11] ("the Dodd-Frank Act")

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ALJ's decision provided for a right to reapply in one year and six months, respectively. *Id.* at *2.

8. For critiques of the appeals procedures in SEC administrative proceedings, see *infra* Part I.

9. More than thirty federal agencies employ administrative law judges. *See Agencies Employing Administrative Law Judges*, ASS'N ADMIN. L. JUDGES, https://www.aalj.org/agencies-employing-administrative-law-judges (last visited Nov. 19, 2016) [https://perma.cc/P5L8-4FZZ]; *see also* David T. Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1202 (2016) ("[M]any other agencies use ALJs to adjudicate claims that would otherwise come within the jurisdiction of the federal courts."); Peter J. Henning, *Reforming the S.E.C.'s Administrative Process*, N.Y. TIMES (Oct. 26, 2015), http://www.nytimes.com/2015/10/27/business/dealbook/reforming-the-secs-administrative-process.html ("If [the Commission's administrative] system somehow deprives respondents of a measure of due process, then can't the same be said for other agencies—like the Federal Trade Commission and banking regulators—that use the same means to police the industries in their jurisdiction?") [https://perma.cc/2ANE-KLKK].

10. For examples of longstanding criticisms of the Commission's internal processes, see ADMIN. CONF. OF THE U.S., 1 ACUS 571. RECOMMENDATION NO. 21: DISCOVERY IN AGENCY ADJUDICATION (1970) (advocating for broadened discovery in SEC administrative proceedings); Comm. on Fed. Regulation of Sec., *Report of Task Force on the SEC Administrative Law Judge Process*, 47 BUS. LAW. 1731, 1731 (1992) (urging an SEC task force to consider and recommend procedural reforms to administrative proceedings "aimed at improving the fairness of SEC administrative proceedings"); Robert A. Downing & Richard L. Miller, *The Distortion and Misuse of Rule 2(e)*, 54 NOTRE DAME LAW. 774, 782 (1979) (criticizing SEC proceedings "where the SEC is not only the investigator but the prosecutor and judge as well"); Arthur F. Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 CATH. U. L. REV. 215, 251 (1980) ("This lack of formal pretrial discovery rights remains one of the low points in the otherwise fair SEC administrative adjudicatory procedures.").

11. Pub. L. No. 111-203, 124 Stat. 1376 (2010). Prior to adoption of the Dodd-Frank Act, the Commission could seek monetary penalties only in administrative actions against regulated entities (brokerage firms, investment advisers, and investment companies) and persons associated with regulated entities. *See* 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/HT24-CBYT]. In 2009, the Commission sought to expand its powers by requesting from Congress the authority to order monetary penalties in cease-and-desist proceedings filed in the administrative forum. *See SEC's "Wish List" of 42 Changes It Seeks in the Federal Securities Laws*, SEC. DOCKET (July 16, 2009, 2:48 PM), http://www.securitiesdocket.com/2009/07/16/sec-s-wish-list-of-42-changes-it-seeks-in-the-federal-securities-laws/ [https://perma.cc/C85A-C28P]. Congress granted this request when it passed section 929P(a) of the Dodd-Frank Act, which amended section 8A of the

and to shift litigation that had traditionally been brought in federal court to its in-house administrative proceedings.[12]

This announcement kicked over a hornet's nest of protest as critics trumpeted a long list of complaints about the fairness of the SEC's internal process and its Kafkaesque dimensions.[13] They pointed to data suggesting

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Securities Act, section 21B(a) of the Securities Exchange Act, section 9(d)(1) of the Investment Company Act, and section 203(i)(1) of the Investment Advisers Act, to permit the imposition of civil monetary penalties in administrative proceedings, in addition to the cease-and-desist orders previously available to the Commission. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P(a), 124 Stat. 1376, 1862–64 (codified at 15 U.S.C. § 77h-1(g) (2012)). The Dodd-Frank Act gave the Commission broad authority to impose a civil penalty in an administrative proceeding against any person or company, including unregistered entities and individuals. *See id.* The Commission can now obtain through internal administrative proceedings essentially most of the remedies it might obtain in federal court. *See* Ceresney, Keynote Speech, *supra* note 2 ("As part of Dodd-Frank, Congress expanded the SEC's authority to obtain penalties against any person in an administrative proceeding including unregistered entities and individuals. Under this expanded authority, the Commission has been bringing more enforcement actions in the administrative forum, where it can now obtain the same remedies as in district court."); Ceresney, Remarks to the ABA, *supra* note 4 (noting the expanded authority to obtain civil penalties permitted under section 929P(a) and noting that the SEC "is simply making use of the administrative forum in cases where we previously could only obtain penalties in district court").

12. In late 2013, SEC Director of Enforcement Andrew Ceresney stated, "Our expectation is that we will be bringing more administrative proceedings given the recent statutory changes [enacted through the Dodd-Frank Act]." 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/5R5Z-T9K3]. In June 2014, Ceresney told a D.C. Bar audience that the SEC would choose the administrative forum more often in insider trading cases and other cases that traditionally had been heard by a federal judge or jury. *See* Brian Mahoney, *SEC Could Bring More Insider Trading Cases In-House*, LAW360 (June 11, 2014, 6:53 PM), http://www.law360.com/articles/547183/sec-could-bring-more-insider-trading-cases-in-house [https://perma.cc/KDU5-WUDD]. The Commission was perceived as fulfilling this commitment in 2014 when it filed two contested insider trading cases as administrative proceedings. *See* Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL ST. 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/7XLP-KRLJ]. In October 2014, Ceresney also told the *Wall Street Journal* that "[w]e're using administrative proceedings more extensively," while Kara Brockmeyer, head of the Commission's Foreign Corrupt Practices Act (FCPA) unit, described administrative proceedings as "the new normal." *Id.* In late 2014, the Commission took steps to prepare for an increased administrative caseload by adding two new ALJs, bringing the total to five. *See* Press Release, SEC, SEC Announces New Hires in the Office of Administrative Law Judges (June 30, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542202073 [https://perma.cc/9EXX-HMNW].

13. *See, e.g.*, *Oversight of the SEC's Division of Enforcement: Hearing Before the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the Comm. on Fin. Servs.*, 114th Cong. 3 (2015) (statement of Scott Garrett, Chairman, Subcomm. on Capital Mkts. & Gov. Sponsored Enters.) (commenting that the administrative process illustrates a "very troubling pattern of the SEC's attempting to stack the rules and process in a way that the outcome of the case is, well, predetermined"); Tanya J. Dmitronow & Scott J. Fishwick, *Critics Question SEC's Increasing Use of Administrative Enforcement Proceedings*, NAT'L L. REV. (Nov. 20, 2014), http://www.natlawreview.com/article/critics-question-sec-s-increasing-use-administrative-enforcement-proceedings (discussing criticism of the Commission's recent shift to the administrative forum) [https://perma.cc/MW2Z-LUMG]; Peter J. Henning, *S.E.C. Faces Challenges over the Constitutionality of Some of Its Court Proceedings*, N.Y. TIMES:

that the Commission enjoyed a significant home-court advantage when litigating before its own ALJs[14] and challenged the constitutionality of the process by which the Commission appointed its ALJs.[15] Critics also waxed poetic about the Commission's internal procedures as an affront to the principles of due process that can be traced back to the Magna Carta.[16] It was as though a dam holding back pent up rage about the fairness of the Commission's administrative proceedings had suddenly burst.

The Commission then doubled down. In a controversial opinion, the Commission overruled a rare ALJ decision favoring the respondent and, in so doing, emphasized the need for *Chevron* deference[17] to the SEC's interpretation of the federal securities laws.[18] The Commission's opinion was subsequently vacated on appeal by the First Circuit, but the policy damage was done.[19] Federal judges and other observers warned that the SEC was embarking on a path that would fundamentally alter the common law process that had governed the interpretation of the federal securities

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DEALBOOK (Jan. 27, 2015, 8:58 AM), http://dealbook.nytimes.com/2015/01/27/s-e-c-faces-challenges-over-the-constitutionality-of-some-of-its-court-proceedings/ (noting that "a recent push by the agency to bring more cases before its administrative law judges rather than filing charges in federal district court is drawing increased attacks from defense lawyers claiming that the entire process is not just unfair, but also unconstitutional") [https://perma.cc/LT4R-EWTQ]; William McLucas & Matthew Martens, *How to Rein in the SEC*, WALL ST. J. (June 2, 2015, 6:55 PM), http://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747 (observing that "[o]ver the past year or so, commentators, judges, the defense bar and Congress have assailed efforts by the Securities and Exchange Commission to move more of its enforcement actions out of federal court and into the agency's in-house hearings") [https://perma.cc/8ZFH-FPM8]; Michael S. Piwowar, Comm'r, SEC, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly, and Efficient SEC (Feb. 20, 2015), http://www.sec.gov/news/speech/022015-spchcmsp.html ("Commission staff has recently indicated that they will recommend instituting more enforcement matters, including insider trading cases, through administrative proceedings rather than going through the federal district courts. . . . [T]his change has the appearance of the Commission looking to improve its chances of success by moving cases to its in-house administrative system.") [https://perma.cc/D5EF-GXHX]; *see also infra* Part I.

14. For an analysis and critique of these data, see *infra* Part III.

15. For a brief summary of this constitutional litigation, see *infra* note 99.

16. Philip Hamburger, Professor, Columbia Law Sch., 2015 Walter Berns Constitution Day Lecture: The Magna Carta, Due Process, and Administrative Power (Sept. 17, 2015), https://www.aei.org/wp-content/uploads/2016/03/The-Magna-Carta-Due-Process-and-Administrative-Power.pdf [https://perma.cc/346X-KE55].

17. *Chevron* deference refers to the standard laid out in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). *See infra* note 83.

18. *See* Flannery, Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31374, 2014 WL 7145625, at *15–18 (Dec. 15, 2014) (overturning an ALJ decision that found respondents not liable on all claims, purporting to resolve many interpretive questions concerning the scope of antifraud liability that arose in the wake of *Janus Capital Group v. First Derivative Traders*, 564 U.S. 135 (2011), and making a bid for *Chevron* deference from the courts for its interpretations by first asserting that there is "ambiguity in Section 10(b), Rule 10b-5, and Section 17(a)" and then claiming that its interpretations are "informed by [the SEC's] experience and expertise in administering the securities laws"), *rev'd*, Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015); *see also infra* note 94.

19. *Flannery*, 810 F.3d at 4 (vacating the Commission's ruling and concluding "that the Commission's findings are not supported by substantial evidence"); *see also infra* note 95.

laws for decades.[20] Instead of federal courts serving as full and active, indeed, sometimes dominant, partners in the evolution of the federal securities laws, the SEC's new regime would greatly expand the Commission's ability to control the evolution of the law: the number of securities law cases subject to interpretation by the federal courts would be diminished as the Commission shifted more litigation to the administrative forum. Federal courts would then be limited to resolving securities law issues primarily as raised in private civil actions and federal criminal cases. And, in both of those categories, the Commission would insist on *Chevron* deference to its prior administrative rulings. All of this would marginalize the role of the Article III judiciary and elevate the importance of the Commission itself and of its ALJs in controlling the evolution of the federal securities laws.

Congress has also entered the fray with two legislative proposals. The Due Process Restoration Act[21] would provide a mandatory right of removal to certain respondents in administrative proceedings and would raise the burden of proof for some cases to a "clear and convincing evidence" standard.[22] The full Committee on Financial Services of the U.S. House of Representatives approved this proposed legislation in early 2016.[23] Around

20. *See, e.g.*, Jed S. Rakoff, Judge, S.D.N.Y, Keynote Address at PLI Securities Regulation Institute: Is the S.E.C. Becoming a Law Unto Itself? 11 (Nov. 5, 2014), http://assets.law360news.com/0593000/593644/Sec.Reg.Inst.final.pdf (noting that administrative interpretation of the securities laws—a task historically borne by federal courts—"would not be good for the impartial development of the law in an area of immense practical importance" and is "unlikely . . . to lead to as balanced, careful, and impartial interpretations as would result from having those cases brought in federal court") [https://perma.cc/HBW2-Y35M]; *see also* CTR. FOR CAPITAL MKTS. COMPETITIVENESS, U.S. CHAMBER OF COMMERCE, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES 19 (2015) [hereinafter CHAMBER OF COMMERCE REPORT] (suggesting that "[t]he Commission should resist utilizing its administrative forum for [the purpose of superseding a judicial opinion with which it disagrees] in the absence of compelling circumstances making such an effort an appropriate use of its Dodd-Frank-granted choice of forum capabilities"); Andrew Vollmer, SEC *Revanchism and the Expansion of Primary Liability Under Section 17(a) and Rule 10b-5*, 10 VA. L. & BUS. REV. 273, 278 (2016) ("The cumulative effect of an agency's decision to roll back Supreme Court precedent and to consolidate for itself ultimate decision-making power over questions of law traditionally left to the courts would seriously alter the balance of responsibility between agencies and courts long recognized in our system of government.").

21. H.R. 3798, 114th Cong. (2015). This bill would allow a respondent, against whom the Commission seeks a cease-and-desist order and monetary penalty, to require termination of his or her administrative proceeding, at which point the Commission could choose to refile charges in federal court. *See id.*

22. *See id.*

23. *See* H.R. REP. NO. 114-697, at 1 (2016) ("The Committee on Financial Services, to whom was referred the bill (H.R. 3798) to amend the Securities Exchange Act of 1934 . . . report favorably thereon without amendment and recommend that the bill do pass."); Janet Levaux, *House Bill to Weaken SEC Enforcement Moves Ahead*, THINKADVISOR (Mar. 2, 2016), http://www.thinkadvisor.com/2016/03/02/house-bill-to-weaken-sec-enforcement-moves-ahead [https://perma.cc/9WSE-JSX9]. The bill's potentially broad chilling effect on the Commission's enforcement program has been broadly noted. *See, e.g.*, Henning, *supra* note 9 ("If it was a mistake to give the S.E.C. such broad authority to bring administrative cases, then using an indirect measure like Mr. Garrett's

that same time, the Republican chairman of the House Financial Services Committee unveiled a second legislative proposal, the Financial CHOICE Act.[24] This proposal would also give respondents in SEC administrative proceedings the right to remove the enforcement action to federal court and would repeal the practice of judicial deference to SEC interpretation.[25]

The Commission has responded with a vigorous defense of its internal proceedings as fair and efficient and has urged that its ALJs are unbiased.[26] The Commission also has emphasized its expertise, and the expertise of its ALJs, in interpreting the federal securities laws.[27] Indeed, a large body of precedent supports the formal legitimacy of the administrative proceedings of the sort relied upon by the Commission.[28]

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proposal to raise the burden of proof that will keep almost every case out of the administrative process seems like a blunderbuss solution to a narrow problem."); David Zaring, *The Due Process Restoration Act of 2015 Would Kill Administrative Adjudication at the SEC*, CONGLOMERATE (Nov. 3, 2015), http://www.theconglomerate.org/2015/11/the-due-process-restoration-act-of-2015-would-kill-administrative-adjudication-at-the-secnd-.html (suggesting that Mr. Garrett's bill "would basically kill things for SEC ALJs") [https://perma.cc/SU83-TT22]; Letter from Americans for Fin. Reform, to Congress (Mar. 2, 2016), http://www.valuewalk.com/2016/03/due-process-restoration-act/ (urging members of Congress to oppose the Due Process Restoration Act because it "would make it more difficult for the Securities and Exchange Commission (SEC) to hold companies accountable when they break the law—even as those same firms frequently deny basic due process to their investors and customers through forced arbitration") [https://perma.cc/GA7E-5NZQ].

24. *See generally* H. COMM. ON FIN. SERVS., THE FINANCIAL CHOICE ACT, CREATING HOPE AND OPPORTUNITY FOR INVESTORS, CONSUMERS, AND ENTREPRENEURS (2016) [hereinafter THE FINANCIAL CHOICE ACT], http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf [https://perma.cc/2AXN-NDYZ]. The Financial CHOICE Act would, among other changes, roll back many of the regulations imposed by the Dodd-Frank Act and other postcrisis regulatory initiatives, end "too big to fail" and bank bailouts, and impose enhanced penalties for financial fraud and self-dealing, including by enhancing the penalty powers of the SEC. *See id.* at 2–16. This bill has been criticized for substantially increasing penalties, *see* J.W. Verret, *Where the Financial CHOICE Act Goes Wrong*, FORBES (July 19, 2016, 9:48 AM), http://www.forbes.com/sites/realspin/2016/07/19/financial-choice-act-goes-wrong/#1e92cf1b6f90 [https://perma.cc/45KS-4SUL], and for "open[ing] the door to certain risky business practices that helped contribute to the financial crisis," Andrew Soergel, *Hensarling's Dodd-Frank Kryptonite Draws Mixed Response*, U.S. NEWS & WORLD REP. (June 7, 2016, 2:50 PM), http://www.usnews.com/news/articles/2016-06-07/hensarlings-dodd-frank-kryptonite-draws-mixed-response [https://perma.cc/E566-E3DS].

25. *See* THE FINANCIAL CHOICE ACT, *supra* note 24.

26. *See, e.g.*, Ceresney, Keynote Speech, *supra* note 2 ("I believe both federal district court and administrative proceedings are fair forums."); Ceresney, Remarks to the ABA, *supra* note 4 (indicating that the "administrative forum is eminently proper, appropriate, and fair to respondents"); SEC, *Investor Advisory Committee Meeting* (Oct. 15, 2015), http://www.sec.gov/news/otherwebcasts/2015/investor-advisory-committee-101515.shtml (Andrew Ceresney, Director of the SEC's Division of Enforcement, remarking, "I think generally, from our perspective, the [administrative proceeding] is a fair forum, notwithstanding that it has different procedures than a district court.") [https://perma.cc/L842-78KC].

27. *See infra* Part I.

28. *See supra* note 1 (observing that administrative proceedings have been used as an alternative to federal court litigation since the SEC's creation); *see also* Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2016 WL 4191191, at *3–4 (D.C. Cir. Aug. 9, 2016) (recognizing the long history of SEC administrative proceedings). Further, "[t]here is long-settled authority upholding the SEC administrative enforcement regime against constitutional

Each side of the debate has relied on empirical data to support its position. Critics interpret the data as suggesting that the Commission has a home-field advantage in administrative proceedings.[29] Critics also suggest that the Commission seeks to bring more cases in-house in order to prevail on claims that might not succeed if brought in federal court.[30] The Commission responds with data indicating that there are no material differences in its success rate in administrative and federal court proceedings.[31] However, the data regarding the Commission's win-loss record is more nuanced than either side suggests. The Commission fares relatively poorly in insider trading litigation both in federal court and before its own ALJs. More precisely, the Commission prevailed in only eight of the fifteen (53 percent) insider trading cases resolved in fiscal years 2014, 2015, and 2016—through March 4, 2016.[32] The SEC also lost the single insider trading case brought before an ALJ during that period.[33] But when insider trading cases are excluded from the analysis, the Commission attains a high success rate regardless of whether it litigates in the administrative or federal forum: it prevails in 97 percent of cases litigated before ALJs and in 96 percent of cases litigated in federal court, with this difference being statistically indistinguishable.[34] However, this data must be interpreted with caution because selection bias makes it difficult to draw reasonable inferences from win-loss ratios, even if statistically significant differences arise across administrative and federal forums, which is not the case.

The data regarding the forums in which the Commission files settled matters do, however, show a remarkable shift toward the administrative forum. In fiscal year 2013, the Commission filed 35 percent of its settled matters involving publicly traded companies in an administrative forum.[35] In fiscal years 2014 and 2015, the percentage of actions filed against publicly traded issuers in the administrative forum had more than doubled

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challenge—even when finding the SEC has made a mistake within it." Thomas K. Potter III, *A Renewed Fight Over SEC's Admin Forum Constitutionality*, LAW360 (Oct. 9, 2014, 10:30 AM), http://www.law360.com/articles/585756/a-renewed-fight-over-sec-s-admin-forum-constitutionality [https://perma.cc/ZSQ9-ZUFN]; *see also* Zaring, *supra* note 9, at 1159–60 ("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. It violates no rights, nor offends the separation of powers; if anything, scholars have bemoaned the fact that it 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."); *infra* note 76 (noting that the Seventh Amendment does not bar adjudication of disputes in an administrative forum).

29. *See infra* Part III.

30. *See infra* Part III.

31. *See infra* Part III.

32. *See infra* Part III.

33. *See* Bolan, Jr., Release No. 877, 2015 WL 5316569 (ALJ Sept. 14, 2015) (dismissing claims brought administratively against a former Wells Fargo trader), *review granted by* Ruggieri, Securities Act Release No. 9985, Exchange Act Release No. 76614, 2015 WL 8519533 (Dec. 10, 2015).

34. *See infra* Part III.

35. *See* NYU POLLACK CTR. & CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY AGAINST PUBLIC COMPANY DEFENDANTS: FISCAL YEARS 2010–2015, at 5 fig. 4 (2016).

to 75 percent.[36] Critics complain that this shift demonstrates that the Commission favors administrative proceedings because of a home-court advantage. In reality, however, these data are exceptionally difficult to interpret because of an identification problem. Respondents have incentives to prefer administrative settlements over federal injunctions, and the dramatic post-Dodd-Frank shift to administrative settlement therefore may reflect respondent preferences at least as much as the Commission's agenda. The inference of home-court advantage based on these settlement data could therefore be ill founded.

But none of this is to suggest that the choice of forum is a matter of indifference. For example, with regard to the law of insider trading, the Commission has made it clear that it disagrees with the Second Circuit's decision in *United States v. Newman*,[37] which held that the personal benefit necessary to establish tippee liability must be pecuniary in nature.[38] The Commission's decision in *Flannery*[39] makes clear that its interpretation of *Janus Capital Group v. First Derivative Traders*,[40] differs from the interpretation adopted by several lower courts.[41] And, the U.S. Supreme Court has, on more than one occasion, rejected the Commission's favored interpretation of federal securities laws.[42]

However, the Commission has not been entirely deaf to complaints about its administrative procedures. For example, the Commission has recently amended its Rules of Practice to allow for a limited number of depositions in administrative proceedings and to extend the timeline for some of its hearings.[43] These concessions were quickly criticized as too modest and

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36. *See id.*

37. 773 F.3d 438 (2d Cir. 2014).

38. *See, e.g.*, Brief for Securities and Exchange Commission as Amicus Curiae Supporting Petition of the United States for Rehearing or Rehearing En Banc at 1–2, United States v. Newman, No. 13-1837, 2015 WL 1954058 (2d Cir. Apr. 3, 2015) (arguing that the Second Circuit's ruling in *Newman* was "directly at odds with Supreme Court and prior Second Circuit decisions" and "creates uncertainty about the precise type of benefit that the panel believes an insider who tips confidential information must receive to be liable").

39. Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31374, 2014 WL 7145625 (Dec. 15, 2014), *rev'd*, Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015).

40. 564 U.S. 135 (2011).

41. *See supra* note 18; *infra* note 94. The First Circuit's decision in *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2015), to vacate the Commission's opinion was based on a finding that the factual record could not support the SEC's decision and expressed no view regarding the Commission's legal interpretation. *See id.* at 4. Because the Commission's decision was vacated, the Commission's legal analysis has no precedential effect. *See, e.g.*, O'Connor v. Donaldson, 422 U.S. 563, 577 n.12 (1975) ("Of necessity our decision vacating the judgment of the Court of Appeals deprives that court's opinion of precedential effect . . . ."); Durning v. Citibank, N.A., 950 F.2d 1419, 1424 n.2 (9th Cir. 1991) ("[A] decision that has been *vacated* has no precedential authority whatsoever."). Nonetheless, the record is clear that, given the opportunity, the Commission is willing to part with federal courts on matters of legal interpretation.

42. *See infra* note 97.

43. For a discussion of these amendments, see *infra* Part II.

unresponsive to the fundamental flaws inherent in the administrative process.[44]

In defending its shift to administrative proceedings, the Commission also points to section 929P(a) of the Dodd-Frank Act.[45] That provision, for the first time, grants the SEC authority to impose civil penalties on nonregulated entities in administrative proceedings.[46] The Commission can easily reason that Congress would not grant it this expansive new authority unless Congress intended that the Commission exercise this authority precisely by suing a larger number of alleged violators in administrative proceedings rather than in federal court.[47] Otherwise, what purpose would the legislative grant serve? From this perspective, the Commission's expanded emphasis on administrative proceedings is entirely consistent with congressional intent.

More fundamentally still, the U.S. litigation process commonly confers on plaintiffs a first-mover advantage in selecting a litigation forum.[48] Private party plaintiffs regularly search for the forum in which they have the best chance of prevailing, as do federal and state prosecutors when they file criminal claims.[49] Why then the kerfuffle when the SEC exercises a forum selection option by electing to bring an action in an administrative forum rather than in federal court?

The answer to this question is, I think, central to the resolution of the current controversy. Typically, when a plaintiff selects a forum, the fact-finder is not in the plaintiff's employ, the appeal is not to the plaintiff itself, and the plaintiff does not control the rules governing the proceeding. The appearance of impropriety under these circumstances is clear, even if one believes that the administrative process is itself largely fair and efficient.

Viewed from this perspective, the appropriate objective is not to end the Commission's reliance on administrative proceedings, or even necessarily to reform those proceedings so that they more closely mimic federal district court trials. Instead, the more appropriate objective may be to assure that

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44. *See infra* Part II.

45. *See supra* note 11.

46. *See supra* note 11.

47. *See* Henning, *supra* note 9 ("The Dodd-Frank Act gave the S.E.C. the authority to choose the forum for almost any case, so if there is a culprit here it is Congress, not the agency. It can be argued that the S.E.C. pushed too hard in bringing more cases before its in-house judges, but using the tools provided by Congress to its advantage should not have come as any great surprise.").

48. *See, e.g.*, Anthony L. Ryan, *Principles of Forum Selection*, 103 W. VA. L. REV. 167, 170 (2000) (observing that "venue statutes typically let the plaintiff choose among a number of courts" and "grant[] the plaintiff leeway to select a venue that he considers convenient to him, or—and the two are often corollaries—inconvenient to the defendant").

49. *See, e.g.*, Mary Garvey Algero, *In Defense of Forum Shopping: A Realistic Look at Selecting a Venue*, 78 NEB. L. REV. 79, 80 (1999) ("[A]ttorneys filing lawsuits or defending against lawsuits usually have the same objective when it comes to evaluating or seeking a venue—they seek a venue in which their clients can not only get a fair trial, but in which their clients might gain some advantage or begin with the odds in their favor."); Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 342 (2013) (suggesting that plaintiffs select forums "to secure a tactical advantage").

the mechanism for allocating enforcement matters between administrative and federal forums is fair and acts to provide the Commission with incentives to refresh its internal rules to reflect contemporary litigation realities. Indeed, proposals that would dramatically cut back on the SEC's ability to rely on administrative proceedings could result in a flood of potentially complex litigation to the federal courts, which already complain that they are overburdened.[50] That result is not clearly in the public interest.

So framed, the current debate over the Commission's shift to administrative proceedings presents a problem of institutional design.[51] If a trusted, independent third party, and not the Commission, decided whether any particular case was more fairly and efficiently resolved in an administrative proceeding rather than in federal court, then much of the consternation over the Commission's administrative proceedings would be removed. This independent third party's decisions also could provide incentives for the ongoing modernization of the SEC's internal procedures because the more credible the Commission's claims of fairness and efficiency, the higher the probability that the independent third party would allow the Commission to retain jurisdiction over a larger number of proceedings.

This Article proposes a removal statute that casts the federal judiciary in the role of a trusted, independent third party tasked with the responsibility of determining whether a Commission enforcement proceeding should proceed as an administrative action or in federal court. To economize on the decision-making costs associated with the introduction of the federal courts as such a "traffic cop," this Article proposes that Commission enforcement proceedings be divided into three categories. The first category would include all cases statutorily required to be litigated in the administrative forum as well as all cases for which administrative proceedings are appropriate because of the nature of the question presented and the SEC's specialized expertise. For example, cases alleging violations of the Commission's complex net capital rules, late filing of documents, and the failure to register with the SEC might rationally fall into this category.[52]

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50. By making removal mandatory upon the request of certain respondents, the Due Process Restoration Act threatens to increase the congestion of federal court dockets by shifting a number of cases out of the administrative forum and into federal court. For criticism of the bill, see *supra* note 23. For an example of a discussion of the perpetual "'crisis' of 'underfunded' courts, crowded dockets and justice delayed," see Stephen J. Ware, *Is Adjudication a Public Good?: "Overcrowded Courts" and the Private Sector Alternative of Arbitration*, 14 CARDOZO J. CONFLICT RESOL. 899, 900–04 (2013).

51. For examples of discussions of mechanism design or institutional design as applied to federal securities regulation, see generally Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15 (2010); David Freeman Engstrom, *Agencies as Litigation Gatekeepers*, 123 YALE L.J. 616 (2013); Zachary J. Gubler, *Reconsidering the Institutional Design of Federal Securities Regulation*, 56 WM. & MARY L. REV. 409 (2014).

52. For a more detailed discussion of this categorization, see *infra* Part IV.

At the other extreme, a second category would be composed of cases that must be heard in federal court and that may not be brought in administrative proceedings except with defendants' consent. Clearly, litigation calling for remedies unavailable in administrative proceedings (such as freeze orders, orders of contempt, or subpoena enforcement proceedings) would fall in this category and could not be heard in the administrative forum even with respondents' consent. Beyond these easy cases, the definition of this category is sure to be controversial, but, as a first cut, it might be reasonable to suggest that, in light of the Commission's checkered insider trading litigation history, insider trading allegations be resolved in federal court unless the defendants consent to an administrative proceeding. This category also could be expanded to include cases that seek significant monetary penalties or that satisfy other objective indicia of complexity.

The third category would be composed of cases that fall in neither of these two categories. In these residual cases, if the Commission decides to bring an administrative action, then the respondent would be permitted to petition a federal district court for removal at the court's discretion. This removal process would be modeled on Federal Rule of Civil Procedure 23(f),[53] and the statute would articulate criteria and time deadlines governing the removal process. In determining whether to grant a petition for removal, the court would assess the relative merits of administrative versus judicial resolution for the specific facts and legal questions presented by the case at issue. The court also would balance the efficiency considerations associated with docket loads in the federal judiciary. The greater the federal judiciary's confidence in the ability of the Commission's administrative process to resolve a dispute fairly and efficiently, the greater the probability that a court would allow the case to continue in the administrative forum.

This statutory sorting mechanism would help assure that (1) cases that belong in the administrative process stay in the administrative process; (2) cases that belong in the federal courts remain in the federal courts; and (3) cases that could reasonably be resolved in either forum are allocated by a trusted, independent third party through a mechanism that also incentivizes the Commission to improve its internal procedures. This approach differs significantly from other proposals that would, in a rather undifferentiated fashion, cause a large scale and de facto automatic shift of litigation from the administrative forum to federal court.[54]

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53. FED. R. CIV. P. 23(f) ("A court of appeals may permit an appeal from an order granting or denying class-action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 14 days after the order is entered. An appeal does not stay proceedings in the district court unless the district judge or the court of appeals so orders.").

54. Commentators have offered various proposals for allowing respondents to transfer cases out of the administrative forum and into federal court. For a discussion of the Due Process Restoration Act and the Financial CHOICE Act and for criticism of those bills, see *supra* notes 21–24. Christopher Cox, former Chairman of the SEC, has suggested that "a party who is not a regulated person or entity and who is charged in an administrative proceeding could safely be given the right to remove to federal court." Chris Cox, Partner,

Part I of this Article details the historical operation of the Commission's internal administrative procedures and summarizes the consternation over those procedures. Part II describes the Commission's recent response to these critiques, including amendments to its internal rules of procedure. Part III analyzes empirical data cited by both sides to the debate. Finally, Part IV sets forth the rationale for a three-part removal statute as a mechanism for resolving this dispute, outlines the structure of the proposed statute, and describes the legal engineering required to operationalize the proposal.

## I. CONSTERNATION OVER THE SEC'S ADMINISTRATIVE PROCEDURES

Critics have historically presented a long list of complaints about the fairness of the SEC's internal procedures. However, these complaints must be evaluated in the context of recently adopted amendments to the Commission's Rules of Practice[55] that were designed to respond to at least some of these critiques. To better frame the debate about the structure and fairness of the Commission's administrative proceedings, this part describes the rules governing the SEC's administrative proceedings as those rules existed prior to the recent amendments. Part II then describes the Commission's newly amended rules and observes that the SEC's critics remain unmollified by amendments they describe as "modest and incremental reforms" that "do little to address the most fundamental inequities of the SEC's in-house courts and continue to leave respondents before an ALJ at a significant disadvantage."[56]

Historically, one of the more frequently voiced complaints against the SEC's Rules of Practice was that proceedings were prosecuted on a rapid timetable[57] that disadvantaged respondents by leaving them inadequate time

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Morgan, Lewis & Bockius, The Growing Use of SEC Administrative Proceedings: An Historical Perspective from Congress and the Agency, Remarks at Securities Enforcement Forum West (May 13, 2015), http://www.securitiesdocket.com/wp-content/uploads/2015/05/2015-05-13-Speech-to-Securities-Enforcement-Forum-West-San-Francisco.pdf [https://perma.cc/DVV4-7TJZ]. The Chamber of Commerce has also suggested that "persons and entities seeking a jury trial [should be permitted] to immediately have the case removed to a federal court, conditioned on timely filing of a notice of removal for a jury trial." CHAMBER OF COMMERCE REPORT, *supra* note 20, at 20.

55. *See generally* Amendments to the Commission's Rules of Practice, Exchange Act Release No. 78319, 2016 WL 3853756 (July 13, 2016) [hereinafter SEC Final Rules].

56. *The SEC Retains Its House Advantage During Administrative Proceedings*, CADWALADER WICKERSHAM & TAFT LLP (Aug. 5, 2016) [hereinafter CADWALADER], http://www.cadwalader.com/resources/clients-friends-memos/the-sec-retains-its-house-advantage-during-administrative-proceedings [https://perma.cc/CG2J-C39W].

57. Prior to the recent amendments, 17 C.F.R. § 201.360 stated that

> [i]nitial decisions must be filed within the number of days prescribed in the order instituting proceedings—120, 210, or 300 days from the date of service of the order instituting proceedings. Broadly speaking, administrative proceedings instituted pursuant to Section 12(j) of the Exchange Act are designated as 120-day cases, administrative proceedings seeking sanctions as a result of an injunction or conviction are designated as 210-day cases, and administrative proceedings alleging violations of the securities laws were designated as 300-day cases.

to prepare a defense.[58] Respondents also were severely limited in their ability to take depositions and to engage in other forms of exploratory discovery typically available in federal court.[59] Instead, a respondent's

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Amendments to the Commission's Rules of Practice, 80 Fed. Reg. 60,091, 60,092 (proposed Oct. 5, 2015) (to be codified at 17 C.F.R. pt. 201). It bears emphasis that the actual number of days available for a respondent to prepare for the hearing, once the order instituting proceedings was filed, was materially shorter than these time periods indicate because these time periods include the period during which the ALJ prepared and filed the decision in the case, as well as the time period during which the hearing itself was conducted. A 120-day timeline anticipated approximately one month from the order instituting proceedings to the hearing, approximately two months for the parties to review the transcript and submit briefs, and approximately one month after briefing for the hearing officer to issue an initial decision. 17 C.F.R. § 201.360(a)(2) (2016). A 210-day timeline anticipated approximately two and one-half months from the order instituting proceedings to the hearing, approximately two months for the parties to review the transcript and submit briefs, and approximately two and one-half months after briefing for the hearing officer to issue an initial decision. *Id.* A 300-day timeline anticipated approximately four months from the order instituting proceedings to the hearing, approximately two months for the parties to obtain the transcript and submit briefs, and approximately four months after briefing for the hearing officer to issue an initial decision. *Id.*

58. Critics contend that these deadlines were "unrealistic" and that they significantly curtailed "the ability of defense counsel to fully develop and present a robust defense in an administrative proceeding." Alan M. Lieberman, *Fast-Track Justice: Is the SEC Exercising 'Unchecked and Unbalanced Power'?*, WESTLAW J. SEC. LITIG. & REG., Sept. 18, 2014, at 1; *see also* CHAMBER OF COMMERCE REPORT, *supra* note 20, at 17 ("The lack of adequate discovery opportunities and sufficient time to prepare for trials are serious disadvantages that raise fundamental issues as to the efficacy of bringing complex litigation under the existing Rules of Practice."); Ryan Jones, *The Fight over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 524 (2015) ("The SEC administrative courts' unrealistic time constraints relating to decision issuances are perhaps the forum's most prominent procedural disadvantage. . . . Given all of these time pressures, administrative respondents are more likely to settle, even if they think that their case has merit."). This problem is likely to be exacerbated as increasingly complex insider trading and financial fraud cases are pursued in the administrative forum. *See* Jones, *supra*, at 524.

59. Prior to the recent amendments, 17 C.F.R. § 201.233 permitted depositions by oral examination only if a witness would be unable to attend or testify at a hearing. *See* Amendments to the Commission's Rules of Practice, 80 Fed. Reg. at 60,102. Commission rules governing administrative proceedings do not provide for interrogatories or requests for admission. *See* Lieberman, *supra* note 58, at 3. Expert testimony was permitted only when allowed by the ALJ, and requests were routinely denied when the enforcement division objected. *See* Letter from Thomas V. Sjoblom to Senator Mark Kirk 2 (June 24, 2015) [hereinafter Sjoblom Letter] (on file with the *Fordham Law Review*). Even when expert testimony was allowed, Commission rules provided for "minimal pretrial disclosure, d[id] not require an expert report and ha[d] no provision for expert depositions." Lieberman, *supra* note 58, at 3. The only real discovery tool available to respondents was the right to subpoena documents in advance of trial, and even that right was restricted to U.S. territorial boundaries. *See* 17 C.F.R. § 201.232. In addition, respondents who wished to obtain documents had to apply to the ALJ for a subpoena and demonstrate that it was warranted, and the ALJ had discretion to refuse to issue subpoenas that were "unreasonable, oppressive, excessive in scope, or unduly burdensome." *Id.*; *see also Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part III*, SEC. DIARY (Nov. 18, 2015), http://securitiesdiary.com/2015/11/18/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-iii/ ("As a result of this highly restrictive set of rules governing subpoenas by respondents—compared to almost no restrictions for subpoenas issued by the SEC staff during the investigative process—very modest document discovery is possible in SEC administrative proceedings.") [https://perma.cc/S42E-ZWVY]. By contrast, the Federal Rules of Civil Procedure permit broad discovery by all parties of "any nonprivileged matter that is relevant to any party's claim or defense and proportional to the

principal source of evidence was the Commission's own investigative file, which the SEC is required to make available to the respondent relatively early in the proceeding.[60] Respondents also had very little time to review and digest the Commission's investigative material—which could amount to hundreds of thousands of pages of evidence—whereas the Commission's staff would often have had years to build a record that could be carefully fashioned to support the SEC's theory of the case.[61] Limiting discovery in

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needs of the case." *See* FED. R. CIV. P. 26(b)(1); see also Republic of Ecuador v. Mackay, 742 F.3d 860, 866 (9th Cir. 2014) ("We have previously recognized that the scope of permissible discovery under Rule 26 is 'broad.'"). Rule 26 has traditionally been subject to four limitations:

> (1) privileged matter is not discoverable; (2) discovery of material obtained in preparation for trial, including expert testimony, is restricted; (3) a physical or mental examination can be ordered only for good cause and only if physical or mental condition is "in controversy"; and (4) as is indicated by the introductory language of Rule 26(b), the court may limit the scope of discovery in accordance with the rules.

CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 2007 (3d ed. 1998).

60. *See* 17 C.F.R. § 201.230(a).

61. Critics have lambasted the unfairness of permitting the Commission's staff "to investigate matters for several years" and "to interview and take testimony from whomever they choose," while allowing respondents to engage in very little exploratory discovery. Sjoblom Letter, *supra* note 59, at 2; *see also* CHAMBER OF COMMERCE REPORT, *supra* note 20, at 15 ("The lack of pre-hearing discovery adversely affects the respondent rather than the SEC staff. This is because the staff has been able to compile its evidentiary record, including sworn depositions, through its investigation process. In effect, the staff is able to conduct its pre-hearing discovery before beginning the proceeding. The respondents in an administrative proceeding have no comparable opportunity."); Eaglesham, *supra* note 12 ("The move [to administrative proceedings] is creating a backlash among lawyers and defendants, who say in federal court they have more extensive rights to take witness testimony and collect evidence ahead of a trial."); *Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part II*, SEC. DIARY (Nov. 5, 2015), http://securitiesdiary.com/2015/11/05/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-ii/ ("[T]he current discovery provisions for administrative proceedings in the SEC's Rules of Practice are designed to handcuff defense counsel and prevent a fair opportunity to develop a reasonable defense.") [https://perma.cc/AN76-SX85]; Steven E. Hudson, Partner, Kilpatrick Townsend, Comment Letter on Proposed Rule: Amendments to the Commission's Rules of Practice (Dec. 3, 2015) [hereinafter Hudson Comment Letter], https://www.sec.gov/comments/s7-18-15/s71815-5.pdf ("[T]he Enforcement Division enjoys seemingly limitless time to investigate and prepare a case against respondents, while respondents receive very little time to prepare a defense.") [https://perma.cc/3M6R-467H]; Tom Quaadman, Senior Vice President, Ctr. for Capital Mkt. Competitiveness, Comment Letter on Proposed Rule: Amendments to the Commission's Rules of Practice 4 (Dec. 4, 2015) [hereinafter Quaadman Comment Letter], https://www.sec.gov/comments/s7-18-15/s71815-12.pdf ("[T]he lack of adequate pretrial discovery in administrative proceedings is a glaring inadequacy of the current process.") [https://perma.cc/555Q-JFXV]. As one commentator noted:

> The Commission's position is one-sided. It fails to recognize the substantial disadvantage respondents face in relying only on the product of an extensive *ex parte* investigation by the staff. The Commission's refusal to make, at a minimum, deposition discovery discretionary with the ALJ when good cause is shown precludes respondents from obtaining evidence from persons who did not provide testimony in the investigation. Moreover, without deposition discovery from witnesses who testified in the investigation, respondents cannot explore the testimony taken by the staff to obtain additional evidence and to test the credibility of witnesses in advance of hearing.

large part to the independent investigation of the Commission's staff also raised the concern that this staff, particularly toward the end of its investigation, "may have lost some objectivity and may be more concerned with proving its case against particular respondents than with uncovering details that might reveal deficiencies in its position."[62]

In some situations, however, respondents can "shadow" the Commission's investigation by interviewing the same parties that were questioned by the Commission and by attempting to gather the same documents collected by the SEC.[63] These efforts will not always succeed: witnesses who cooperated with the Commission may refuse to speak with respondent counsel, and documents produced to the Commission by third parties may not be voluntarily produced.[64] The Commission's investigation and timing advantages can therefore persist even when the SEC confronts the most diligent and resourceful opposing counsel.

Also, when comparing federal civil litigation with the Commission's administrative proceedings, it warrants mention that the Commission, in administrative proceedings, is required to produce a broad category of documents pursuant to the *Brady* rule[65] and to the Jencks Act[66] but that no such production is required in a civil proceeding filed by the Commission.[67]

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KIRKPATRICK & LOCKHART PRESTON GATES ELLIS LLP, THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES 372 (2d ed. 2007).

62. KIRKPATRICK & LOCKHART PRESTON GATES ELLIS LLP, *supra* note 61, at 373; *see also* Andrew N. Vollmer, *Four Ways to Improve SEC Enforcement*, 43 SEC. REG. L.J. 333, 337–38 (2015) ("The staff is committed to 'winning,' which means having the Commission authorize a proceeding, and that will-to-win warps the fact-gathering process. The staff looks so hard for something that seems wrong or that can be portrayed as wrong that they lose perspective and objectivity."). The result is that counsel for respondents often cannot adequately discover facts in advance of a hearing. *See* KIRKPATRICK & LOCKHART PRESTON GATES ELLIS LLP, *supra* note 61, at 373.

63. *See* Ceresney, Remarks to the ABA, *supra* note 4 ("[I]n many cases respondents know full well what the important evidence is, either because they produced it to us themselves, because it was testimony from their own employees or someone else to whom they have access before the hearing, or because we have shared it with them in testimony or in the course of Wells discussions. So the bottom line is that there are extensive procedural protections in our proceedings and defendants have transparency into the nature of our case and proof well before the hearing commences.").

64. *See, e.g.*, Hudson Comment Letter, *supra* note 61, at 3 (noting that "[p]otential witnesses fear drawing the Enforcement Division's ire and thus avoid any contact with respondents that might lead to those witnesses being called opposite the Division at the final hearing").

65. The *Brady* rule, named for *Brady v. Maryland*, 373 U.S. 83 (1963), requires prosecutors to disclose to the defense any exculpatory evidence material to guilt or punishment that is in the government's possession.

66. *See* 18 U.S.C. § 3500 (2012). The Jencks Act requires the government, upon motion of the defendant and only after a witness has testified on direct examination, to produce "any statement . . . of the witness in the possession of the United States which relates to the subject matter as to which the witness has testified." *Id.* § 3500(b).

67. *See, e.g.*, SEC Final Rules, *supra* note 55, at *16 n.44 ("Under Rule 230, which incorporates certain criminal process rights derived from criminal cases and statutes, respondents receive documents that contain material exculpatory evidence under *Brady v. Maryland*, 373 U.S. 83, 87 (1963). No analogous provision is present in the Federal Rules of Civil Procedure."); Ceresney, Remarks to the ABA, *supra* note 4 (noting that in administrative proceedings the SEC "ha[s] affirmative *Brady* obligations to disclose

By contrast, the SEC's Rules of Practice require the production of only certain categories of documents, such as subpoenas and transcripts, and production is required only by order of the Commission or the hearing officer.[68] Accordingly, the SEC's "watered-down quasi-*Brady* obligation" falls short of the full, compulsory production of exculpatory evidence envisioned by the *Brady* rule.[69] *Brady* rule and Jencks Act obligations in the administrative setting may therefore not level the playing field as much as the Commission suggests.

Further, the Federal Rules of Evidence do not apply in administrative proceedings.[70] Critics complain that the more liberal standard traditionally applied in Commission administrative proceedings allows the Commission to introduce hearsay and other forms of evidence that are impermissible in federal court.[71] The admission of hearsay evidence "effectively undercut[s] the ability of a [respondent] to challenge the offered evidence through cross-examination, traditionally considered as an essential trial right to discovering the truth."[72] Critics also assert that "the looser evidentiary standards in administrative proceedings compound the problem presented by the number of cases the SEC brings based on purely circumstantial evidence, sometimes without a single witness who can relate firsthand knowledge of any wrongdoing by the respondent."[73] The net result is a system that "reward[s] trial by ambush and result[s] in a distorted record."[74]

Critics further point out that juries are available in federal court[75] but not in administrative proceedings.[76] Federal court judges are nominated by the

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material, exculpatory information and Jencks Act obligations to turn over statements of our witnesses—neither of which apply in our district court proceedings").

68. 17 C.F.R. § 201.230(a) (2016).

69. *See, e.g.*, Stephen A. Best et al., *Imposing* Brady*-Like Obligations on the SEC?*, INSIGHTS, June 2014, at 15, 15 ("Because the rule imposes no affirmative duty to disclose exculpatory evidence as such, the SEC need not disclose all exculpatory information in its possession, as the *Brady* decision requires.").

70. *See* 17 C.F.R. § 201.320 (governing the standard for admissibility of evidence in the Commission's administrative proceedings). Prior to the recent amendments, the rule permitted the Commission or hearing officer to "receive relevant evidence and [to] exclude all evidence that is irrelevant, immaterial, or unduly repetitious." Amendments to the Commission's Rules of Practice, 80 Fed. Reg. 60,091, 60,095 (proposed Oct. 5, 2015) (to be codified at 17 C.F.R. pt. 201).

71. *See* Peter J. Henning, *A Small Step in Changing S.E.C. Administrative Proceedings*, N.Y. TIMES (Sept. 28, 2015), http://www.nytimes.com/2015/09/29/business/dealbook/a-small-step-in-changing-sec-administrative-proceedings.html ("One amendment would expressly permit the use of hearsay evidence in the proceeding as long as it 'bears satisfactory indicia of reliability so that its use is fair.' That is not the standard for admitting evidence in federal court actions in which the rules of evidence bar the use of hearsay unless it comes within a clearly prescribed exception.") [https://perma.cc/75RJ-2C8R].

72. Quaadman Comment Letter, *supra* note 61, at 11.

73. William F. Johnson & Amelia R. Medina, *SEC's Administrative Enforcement Intensifies Fairness Debate*, N.Y. L.J., Nov. 6, 2014, at 5.

74. Lieberman, *supra* note 58, at 3.

75. *See* FED. R. CIV. P. 38(a) ("The right of trial by jury as declared by the Seventh Amendment to the Constitution . . . is preserved to the parties inviolate.").

76. *See* Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n, 430 U.S. 442, 455–61 (1977) (holding that Congress could assign the adjudication of new public rights to an administrative SEC with which a jury trial would be incompatible without

President and confirmed by the Senate, whereas ALJs are hired by the Commission.[77] The practice of having SEC employees hear and resolve claims that are filed and prosecuted by the SEC creates the appearance of bias and lack of objectivity.[78] At least one former ALJ has made statements

violating the Seventh Amendment's injunction that jury trials are to be "preserved" in "suits at common law"); Mohawk Excavating, Inc. v. Occupational Safety & Health Review Comm'n, 549 F.2d 859, 865 (2d Cir. 1977) (holding "the seventh amendment is no bar to the imposition of civil penalties through the administrative process without jury trial in the enforcement of this Act"); Hill v. SEC, 114 F. Supp. 3d 1297, 1316 (N.D. Ga. 2015) (holding that, in an action challenging the constitutionality of SEC administrative proceedings, the "[p]laintiff cannot prove a substantial likelihood of success on the merits of his Seventh Amendment claim as this claim involves a public right, and Congress has the right to send public rights cases to administrative proceedings"). Critics bemoan the Commission's unilateral abrogation of an otherwise "inviolate" jury trial right in SEC administrative proceedings, particularly in cases where monetary penalties are sought. *See, e.g.*, Cox, *supra* note 54, at 6 ("Depriving a litigant of a jury trial is undoubtedly efficient, but it may not seem desirable to an individual who feels wrongly accused."); Lieberman, *supra* note 58, at 3 ("In SEC enforcement actions, this 'inviolate' [Seventh Amendment] right can be unilaterally taken from a defendant by the Enforcement Division's decision to file its action as an administrative proceeding."); Russell G. Ryan, *The SEC as Prosecutor and Judge*, WALL ST. J. (Aug. 4, 2014, 7:36 PM), http://www.wsj.com/articles/russell-g-ryan-the-sec-as-prosecutor-and-judge-1407195362 ("Administrative hearings also do not have juries, even when severe financial penalties and forfeitures are demanded. . . . In short, while administrative prosecutions create the illusion of a fair trial, and while administrative law judges generally strive to appear impartial, these proceedings afford defendants woefully inadequate due process.") [https://perma.cc/M439-TQ44]; Suji A. Thomas & Mark Cuban, *A Jury, Not the S.E.C.*, N.Y. TIMES: DEALBOOK (Oct. 16, 2015), http://www.nytimes.com/2015/10/17/business/dealbook/a-jury-not-the-sec.html?_r=0 ("[A] defendant accused of wrongdoing by the government and facing significant monetary penalties should have the option of a jury deciding his case.") [https://perma.cc/U4PC-WD46].

77. *See, e.g.*, Cox, *supra* note 54, at 7 ("However independent they may strive to be, the ALJs are employed by the SEC, draw their paychecks from the SEC, work at SEC Headquarters, and have friends among the enforcement staff."); *see also* KIRKPATRICK & LOCKHART PRESTON GATES ELLIS LLP, *supra* note 61, at 329.

78. *See, e.g.*, Jean Eaglesham, *SEC Wins with In-House Judges*, WALL. ST. J. (May 6, 2015, 10:30 PM), http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803 ("'The SEC appoints the judges, the SEC pays the judges, they are subject to appeal to the SEC,' U.S. District Judge Jed Rakoff said. 'That can create an appearance issue, even if the judges are excellent, as I have every reason to believe they are.'") [https://perma.cc/GE6E-8K6E]; Morgenson, *supra* note 12 ("But some legal experts say these proceedings suffer from potential bias because the judges operate within the agency bringing them. The possibility of a home-court advantage or a sympathetic adjudicator, critics say, raises questions of fairness, especially for individuals defending themselves in these matters.").

Mark Cuban, the billionaire owner of the NBA's Dallas Mavericks, who was acquitted by a federal jury of charges that he committed insider trading, recently filed an amicus brief in support of insider trading defendant, Charles Hill. *See* Motion of Mark Cuban for Leave to File Brief as Amicus Curiae in Support of Plaintiff-Appellee Charles L. Hill, Jr. and Affirmance, Hill v. SEC, 825 F.3d 1236 (11th Cir. 2016) (No. 15-12831). Calling himself a "first-hand witness to and victim of SEC overreach," Cuban's motion opposes the SEC's appeal of Judge Leigh Martin May's decision preliminarily enjoining the SEC's administrative action against Hill. *Id.* at 1. In the motion, Cuban criticized the Commission's administrative proceedings as "inherently biased," *id.* at 6, and "lack[ing] the procedural tools required to reach a fair and accurate result," *id.* at 13. Cuban also attributed his own victory over insider trading charges to "the procedural rules available to him [in federal court], the independence of the judge enforcing those rules, and the independent fact-finding by the jury," pointing out that these protections would not have been available had his enforcement action been filed in an administrative forum. *Id.* at 5. Cuban subsequently

consistent with the existence of bias,[79] but a subsequent investigation by the SEC's Office of Inspector General found no "evidence to support the allegations of improper influence."[80]

Critics also complain that the first-level appeal from the ALJ's decision is not to a federal court, but to the very same Commission that authorized the proceeding in the initial instance.[81] The five Commissioners are thus in the position of acting both as prosecutors and as judges: prosecutors when authorizing the complaint and judges when ruling on the appeal from the ALJ decision resolving the complaint they initially authorized. While respondents have the right to appeal any Commission ruling to a federal court of appeals,[82] this second-level review is also criticized as flawed, most notably because Commission orders are afforded substantially more deference on appeal than are the rulings of federal district court judges.[83]

made additional filings in separate actions that have similarly challenged the constitutionality of the SEC's administrative proceedings. *See* Brief for Mark Cuban as Amicus Curiae Supporting Petitioners, Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016); *see also infra* note 92.

79. Eaglesham, *supra* note 78 (quoting former ALJ Lillian McEwen, who "said she thought the system was slanted against defendants at times" and suggested that she "came under fire from [the SEC's chief ALJ] for finding too often in favor of defendants").

80. OFFICE OF INSPECTOR GEN., SEC, REPORT OF INVESTIGATION: CASE NO. 15-ALJ-0482-I, at 1 (2016). This report also noted that "[f]ormer and current staff affiliated with the Office of ALJs . . . stated that ALJ decisions were made independently and free from influence of SEC Chief ALJ [Brenda] Murray." *Id.*

81. *See* Eaglesham, *supra* note 78 (revealing that from January 2010 through March 2015, the Commission decided in favor of the SEC 95 percent of the time in appeals from ALJ decisions); *see also* Gupta v. SEC, 796 F. Supp. 2d 503, 512 (S.D.N.Y. 2011) ("Indeed, if anything, it would be inherently difficult for the Commission, which will have to approve any final order against Gupta, to be deciding whether it itself engaged in unequal protection in bringing its charges against Gupta."); Luke T. Cadigan, *Litigating an SEC Administrative Proceeding*, BOS. B.J. (Jan. 7, 2014), http://bostonbarjournal.com/2014/01/07/litigating-an-sec-administrative-proceeding/ ("But because the SEC initially determined that there was a sufficient basis for bringing the action, a respondent has a difficult task in convincing the SEC upon appeal that there is no basis for liability.") [https://perma.cc/786L-MWM9]; Cox, *supra* note 54, at 7 ("Litigants who choose to appeal an adverse judgment in an [administrative proceeding] therefore get a very different experience than they would find in federal court. At a minimum, it *appears* to them and to the outside world that the process is much less fair.").

82. *See* 15 U.S.C. § 78y(a)(1) (2012) ("A person aggrieved by a final order of the Commission entered pursuant to this chapter 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."); *id.* § 77i(a) ("Any person aggrieved by an order of the Commission may obtain a review of such order in the court of appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia . . . ."); *see also* 17 C.F.R. § 201.410(e) (2016) ("[P]etition to the Commission for review of an initial decision is a prerequisite to the seeking of judicial review of a final order entered pursuant to such decision.").

83. An appellate court reviews factual determinations made by the Commission under the highly deferential "substantial evidence" standard rather than the "clearly erroneous" standard applied to decisions made by lower court judges. *See* United States v. Abad, 350 F.3d 793, 797 (8th Cir. 2003) (applying the clearly erroneous standard). *Compare* 15 U.S.C. § 78y(a)(4) ("The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive."), *and* 5 U.S.C. § 706(2)(E) ("The reviewing court shall . . . (2) hold unlawful and set aside agency action, findings, and conclusions found to be . . . (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or

Thus, federal courts of appeals "tend to go along with the SEC unless there's an egregious error,"[84] but they apply tighter scrutiny of federal district court rulings.

Critics also dispute the efficiency of administrative proceedings, which the SEC frequently touts as one of the procedural advantages of proceeding in-house.[85] While the path from the order instituting proceedings to the ALJ's initial decision can indeed be rapid, the initial decision is not a final judgment and does not become final until the Commission issues an opinion on appeal or, if no party appeals the initial decision to the Commission, a notice of finality.[86] Therefore, the true length of an administrative

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otherwise reviewed on the record of an agency hearing provided by statute . . . ."), *with* 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."). The "substantial evidence" test "has always involved a large amount of deference to the relevant fact-finder" and "is a more deferential standard than the 'clearly erroneous' standard that [circuit courts] use for reviewing factual determinations by lower court judges." Menendez-Donis v. Ashcroft, 360 F.3d 915, 918 (8th Cir. 2004); *see also* Dickinson v. Zurko, 527 U.S. 150, 153 (1999) ("Traditionally, this court/court standard of review has been considered somewhat stricter (i.e., allowing somewhat closer judicial review) than the APA's court/agency standards."). An appellate court often applies *Chevron* deference to the Commission's legal conclusions, although it reviews de novo the legal findings of a district court judge. *See* Cox, *supra* note 54, at 7; *see also* Tyler L. Spunaugle, *The SEC's Increased Use of Administrative Proceedings: Increased Efficiency or Unconstitutional Expansion of Agency Power?*, 34 REV. BANKING & FIN. L. 406, 410–11 (2015). In *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the Supreme Court ruled that agency regulations "are given controlling weight" if Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation, and unless the regulations are arbitrary, capricious, or manifestly contrary to the statute. *Id.* at 843–44. However, in a critique of the Commission's recent *Flannery* ruling, Professor Andrew Vollmer suggests several reasons why a reviewing court need not, and in many cases should not, grant *Chevron* deference to legal interpretations in an SEC adjudication. *See generally* Vollmer, *supra* note 20. Vollmer points to the statutory text of the Administrative Procedure Act, which commands that "the reviewing court shall decide all relevant questions of law," and which "admit[s] no deference on legal questions." *Id.* at 326–27. Vollmer further observes that the Supreme Court has "not always accepted agency legal conclusions of ambiguous statutes as binding" and that "the actual practice of most courts of appeals is not to defer to the SEC on questions of law in an adjudication." *Id.* at 327–29. Principles of stare decisis also require courts to follow judicial precedent, especially when "an agency interpretation varies from the way the courts, especially the Supreme Court, has been interpreting and applying the same legal provision." *Id.* at 331. Finally, Vollmer observes that significant questions have been raised "about the obligation of a reviewing court to give controlling weight to the SEC's legal interpretations of Section 17(a) and Rule 10b-5" and other laws "that contemplate[] both criminal and administrative enforcement." *Id.* at 333.

84. Eaglesham, *supra* note 78 (quoting Thomas Gorman, a former SEC attorney now at Dorsey & Whitney LLP).

85. *See, e.g.*, Ceresney, Remarks to the ABA, *supra* note 4 ("[A]dministrative actions produce prompt decisions.").

86. *See* 17 C.F.R. § 201.410(e) ("[P]etition to the Commission for review of an initial decision is a prerequisite to the seeking of judicial review of a final order entered pursuant to such decision."); *see also* 15 U.S.C. § 78y(a)(1); *id.* § 77i(a); Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2016 WL 4191191, at *5 (D.C. Cir. Aug. 9, 2016) ("The Commission's final action is either in the form of a new decision after *de novo* review or, by declining to grant or order review, its embrace of the ALJ's initial decision as its own. In either event, the Commission has retained full decision-making powers, and the mere passage of time is not

proceeding must take into account the time required for the Commission to review the initial decision and render a final judgment, which can be quite time consuming. In contrast to ALJs, who operate under strict time constraints, the Commission is under no mandatory deadline when ruling on appeals from ALJ decisions,[87] and its own discretionary guidelines are rarely followed in practice.[88] Indeed, data suggest that after factoring in delays associated with Commission review, "the overall period for completion of an administrative proceeding is likely *slower* than the time required to complete a trial in district court."[89] "[T]he SEC's approach

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enough to establish finality. And even when there is not full review by the Commission, it is the act of issuing the finality order that makes the initial decision the action of the Commission . . . .").

87. When an initial decision is appealed to the Commission, the Rules of Practice dictate that a final order "should" be issued within seven months from the date the petition for review is filed. 17 C.F.R. § 201.900(a)(1)(iii). The Commission can extend the deadline to eleven months from filing of the petition for review if it determines that the matter "presents unusual complicating circumstances." *Id.* The SEC retains discretion to further extend the deadline if it "determines that extraordinary facts and circumstances of the matter so require." *Id.* However, these deadlines are merely aspirational and are, in practice, often violated. *See infra* note 88.

88. *See* CHAMBER OF COMMERCE REPORT, *supra* note 20, at 16 (stating that between October 1, 2013, and March 31, 2015, only two of fifteen Commission opinions were issued within the guidelines period); *see also* Christian J. Mixter, *The SEC's Administrative Law Enforcement Record*, 49 SEC. & COMMODITIES REG. 69, 74–75 (2016) (noting that the Commission failed to meet its seven-month guideline in seventeen of the last twenty reporting periods and failed to meet the eleven-month guideline in ten of the last twenty reporting periods). The median disposition time for the issued opinions extended from 399 days to 600 days. *See* CHAMBER OF COMMERCE REPORT, *supra* note 20, at 16. This is in addition to the time required for the ALJ to conduct a hearing and issue an initial decision. Accordingly, the total time required to move an administrative proceeding from initiation to Commission decision is actually much longer than the Commission concedes and will likely get even longer if the SEC's proposed revisions to the administrative process are implemented. *See, e.g.*, Mixter, *supra*, at 75 (noting that for seven decisions, the average length from the order instituting proceedings to the Commission decision was two and a half years, and that "the Commission's recent proposal to amend its [administrative proceeding] rules augurs a review process that will move yet more slowly in the future"); Jean Eaglesham, *SEC Appeals Process on the Slow Track*, WALL ST. J. (Dec. 21, 2015, 7:12 PM), http://www.wsj.com/articles/sec-appeals-process-on-the-slow-track-1450743130 ("Since Mary Jo White became SEC chairman in April 2013, the median time for the agency to decide appeals of its in-house judges' decisions has increased to 19 months.") [https://perma.cc/77A9-DU74]; Quaadman Comment Letter, *supra* note 61, at 14 ("[R]elaxation of its internal guidelines seems inconsistent with the Commission's stated purpose of improving the efficiency of the process and utilizing administrative proceedings because they are speedier."). The case against Flannery and Hopkins is illustrative. *See* Flannery, Release No. 438, 102 SEC Docket 1392 (Oct. 28, 2011), *rev'd*, Flannery, Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31374, 2014 WL 7145625, at *15–18 (Dec. 15, 2014), *rev'd*, Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015). There, two employees of State Street Bank and Trust Company were charged with securities law violations in an administrative action. *See id.* at 1393. After proceeding through a fast-paced 300-day administrative hearing, respondents waited for more than three years for the SEC Commissioners to decide their appeal. *See* Eaglesham, *supra* ("After five years, four judges, three rulings, two appeals and the loss of their careers, John Flannery and James Hopkins this month won their legal battle against the Securities and Exchange Commission.").

89. CHAMBER OF COMMERCE REPORT, *supra* note 20, at 16 (emphasis added). To be sure, district court cases can also languish for years. As of September 30, 2014, 11 percent

means defendants often lose both ways. The trial portion of the civil case moves much more quickly than such matters typically would in federal court, giving limited time to prepare for trial, and defendants then can wait years for the SEC to decide appeals."[90] In the interim, reputations and careers can be ruined, regardless of the ultimate result.[91]

Taken together, opponents of the Commission's regime complain that the path to circuit court review is long and expensive and that it involves such a high probability of having to operate under the shadow of an adverse finding that the prospect of meaningful review is more theoretical than real for many respondents. They explain that the

> SEC is well aware that most litigants do not have the resources or ability to defend a principle and would be forced to capitulate rather than endure the years of litigation and the extreme resource drain necessary to obtain a fair federal court review of an administrative proceeding. . . . In other words, the SEC is aware that experienced defense counsel perceive the SEC's in-house proceedings to be less fair, and the SEC uses this fact to reduce the number of its cases that are tested in the crucible of federal court, even if only on appeal.[92]

Separate and apart from these complaints about the fairness of the SEC's proceedings as applied to any specific set of facts, concern persists that the Commission's push to administrative proceedings is designed to help the Commission substitute its interpretation of the federal securities laws for the views expressed by the federal judiciary.[93] Indeed, in a recent

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of cases on the district court dockets had been pending for three or more years. *See* U.S. COURTS, JUDICIAL BUSINESS 2014 tbl. C-6 (2014).

90. Eaglesham, *supra* note 88.

91. *See, e.g.*, *id.* (noting that Flannery and Hopkins's "rare victory has come at a price," including several years of litigation and the loss of their careers).

92. Brief for Mark Cuban as Amicus Curiae Supporting Petitioner at 2–3, Bebo v. SEC, 136 S. Ct. 1500 (2016) (No. 15-997) [hereinafter Bebo Amicus Brief].

93. The Commission has made clear that its choice of an administrative forum in particular cases is specifically intended to influence the development of the law. *See* SEC, *supra* note 1. In guidance on forum selection in contested actions issued on May 8, 2015, the Commission stated that

> [i]f a contested matter is likely to raise unsettled and complex legal issues under the federal securities laws, or interpretation of the Commission's rules, consideration should be given to whether, in light of the Commission's expertise concerning those matters, obtaining a Commission decision on such issues, subject to appellate review in the federal courts, may facilitate development of the law.

*Id.*; *see also* William F. Johnson, *Is It Time to Reconsider '*Chevron*' Deference for SEC Proceedings?*, N.Y. L.J. (July 2, 2015), http://www.newyorklawjournal.com/id=1202730989126/Is-It-Time-to-Reconsider-Chevron-Deference-for-SEC-Proceedings?mcode=0&curindex=0&curpage=ALL (noting that the Commission is "increasingly turning toward administrative proceedings with the express intent to develop the law") [https://perma.cc/TVX3-2LX4]; Ceresney, Keynote Speech, *supra* note 2 ("If a contested matter is likely to raise unsettled and complex legal issues under the federal securities laws, or interpretation of the Commission's rules, it may make sense to file the case as an administrative proceeding so a Commission decision on the issue, subject to appellate review in the federal courts, may facilitate development of the law."). Critics contend that administrative interpretation of the securities laws—a task historically borne by federal courts—"would not be good for the impartial development of the law in an area of immense practical importance," and is "unlikely . . . to lead to as balanced, careful, and impartial

administrative proceeding, the SEC made this objective explicit.[94] Even though the Commission's decision in that matter was reversed and vacated,[95] this public policy bell cannot be unrung.

Historically, complex federal securities laws have often been developed and elucidated by federal court judges,[96] and there are many situations in which the Commission's interpretation of the federal securities laws conflicts with decisions reached by federal courts.[97] Because the

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interpretations as would result from having those cases brought in federal court." Rakoff, *supra* note 20, at 11; *see also* CHAMBER OF COMMERCE REPORT, *supra* note 20, at 18 (suggesting that "[t]he Commission should resist utilizing its administrative forum for [the purpose of superseding a judicial opinion with which it disagrees] in the absence of compelling circumstances making such an effort an appropriate use of its Dodd-Frank-granted choice-of-forum capabilities"); Vollmer, *supra* note 20, at 278 ("The cumulative effect of an agency's decision to roll back Supreme Court precedent and to consolidate for itself ultimate decision-making power over questions of law traditionally left to the courts would seriously alter the balance of responsibility between agencies and courts long recognized in our system of government.").

94. *See* Flannery, Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31374, 2014 WL 7145625, at *9–10 (Dec. 15, 2014), *rev'd*, Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015). Citing the SEC's "experience and expertise in administering the securities laws," the Commission opinion set out its own legal interpretation to resolve what it termed "confusion" and "inconsistencies" among the federal district courts concerning the scope of primary liability for fraud under the federal securities laws. *Id.* Critics labeled this opinion "a questionable act of policy-making . . . with no public input" and an attempt "to preempt judicial development of the scope of several aspects of the securities laws by interceding and applying 'agency expertise' to interpret those laws and regulations extremely broadly." *SEC Majority Argues for Negating* Janus *Decision with Broad Interpretation of Rule 10b-5*, SEC. DIARY (Dec. 19, 2014), https://securitiesdiary.com/2014/12/19/sec-majority-argues-for-negating-janus-decision-with-broad-interpretation-of-rule-10b-5/ [https://perma.cc/2S6U-9AV7]; *see also* Vollmer, *supra* note 20, at 277 ("A reading of the *Flannery* decision leaves the definite impression that a majority of SEC Commissioners aimed to use the case as a vehicle to recover much of the territory lost in the enforcement area from the Supreme Court decisions and the lower federal courts that have been following the Supreme Court's lead."); Susan D. Resley et al., *Dealing with the SEC's Administrative Proceeding Trend*, LAW360 (Jan. 13, 2015, 5:10 PM), http://www.law360.com/articles/610688/dealing-with-the-sec-s-administrative-proceeding-trend (suggesting that the *Flannery* ruling illustrated the Commission's "intent to use the administrative forum as a vehicle to interpret the securities laws and regulations aggressively and to attempt administratively to overrule lower court precedent that the SEC does not like") [https://perma.cc/9XUS-YHLY].

95. *See Flannery*, 810 F.3d at 9 (vacating the Commission's order and noting that "where the [Commission] has reached a conclusion opposite of that of the ALJ, our review is slightly less deferential than it would be otherwise" (quoting Haas Elec., Inc. v. NLRB, 299 F.3d 23, 28–29 (1st Cir. 2002))); *see also* Timothy P. Burke et al., *First Circuit Overturns SEC Ruling in* Flannery v. SEC, MORGAN LEWIS & BOCKIUS LLP (Dec. 14, 2015), https://www.morganlewis.com/pubs/first-circuit-overturns-sec-ruling-in-flannery-v-sec ("The First Circuit's decision underscores the limits of court deference to Commission decisions . . . .") [https://perma.cc/87DQ-F28K]; *First Circuit Rebuffs SEC in Flannery and Hopkins Case and Vacates SEC Order*, SEC. DIARY (Dec. 9, 2015), http://securitiesdiary.com/tag/in-re-flannery-and-hopkins/ ("The First Circuit panel found, however, that the underlying evidence simply failed to support the finding of *any* violation on *any* theory, even the aggressive interpretations set forth by the Commission in its opinion.") [https://perma.cc/T6JJ-E6Z3].

96. *See* Rakoff, *supra* note 20, at 8.

97. *See, e.g.*, Dirks v. SEC, 463 U.S. 646, 655–59 (1983) (rejecting the SEC's theory that a recipient of confidential information (i.e., the "tippee") must refrain from trading

Commission expects that its interpretation of the federal securities laws will, under the doctrine of *Chevron* deference, take precedence over conflicting interpretations by the federal courts,[98] the Commission's push to the administrative forum could override decades of well-established judicial precedent fashioned by the federal judiciary and replace it with conflicting Commission interpretations that more aggressively support the SEC's enforcement agenda.

Litigation is also afoot challenging the constitutionality of the process by which ALJs are appointed and can be removed.[99] The resolution of this

"whenever he receives inside information from an insider"); *Flannery*, 810 F.3d at 4 (holding that the Commission's findings of securities law violations lacked substantial evidence and vacating the Commission's order); United States v. Newman, 773 F.3d 438, 448–49 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015) ("[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. Although the Government might like the law to be different, nothing in the law requires a symmetry of information in the nation's securities markets."); Vollmer, *supra* note 20, at 275 (explaining "that much about [the SEC's decision in *Flannery*] is not consistent with, and is antagonistic to, a series of prominent Supreme Court decisions that imposed meaningful boundaries around aspects of primary liability under Rule 10b-5"); *U.S. Supreme Court Limits Securities Fraud Liability to Parties with "Ultimate Authority" over Misstatements*, PAUL WEISS RIFKIND WHARTON & GARRISON LLP (June 15, 2011), https://www.paulweiss.com/media/102462/15Jun11SCOTUS.pdf (noting that the "ultimate authority" test adopted by the Supreme Court in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), for identifying the maker of a statement "is considerably narrower than the test proposed by the SEC") [https://perma.cc/P2LG-TAU8].

98. *See* Rakoff, *supra* note 20, at 10 (noting that "an S.E.C. administrative judge's formal ruling on an otherwise undecided issue of statutory interpretation of the securities law is, just like rules enacted by the Commission, entitled to '*Chevron*' deference"); Vollmer, *supra* note 20, at 275 (noting that in *Flannery*, "[t]he Commission not only advanced expansive legal conclusions, but it also insisted that the courts accept the agency's legal interpretations as controlling"). Critics have questioned whether *Chevron* deference remains appropriate in light of the Commission's increased reliance on its own administrative proceedings to resolve complex questions of federal securities law. *See, e.g.*, Johnson, *supra* note 93 ("[T]he Chevron decision did not appear to foresee nor pre-authorize the ability of the agency to foster a 'home field' litigation advantage to 'develop the law,' particularly in procedural circumstances where it appears the agency has an unfair advantage over respondents compared to federal district court."); *see also* Vollmer, *supra* note 62, at 8 ("It is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or else be held liable when the agency announces its interpretations for the first time in an enforcement proceeding and demands deference." (quoting Christopher v. SmithKline Beecham Corp., 132 S. Ct. 2156, 2168 (2012))). Indeed, in *Chau v. SEC*, 72 F. Supp. 3d 417 (S.D.N.Y. 2014), Judge Lewis Kaplan notes that "it is not at all clear that the Second Circuit definitively has taken the position that Commission interpretations in adjudicatory proceedings are entitled to *Chevron* [deference] . . . . And regardless of what position the Second Circuit takes with respect to *Chevron* deference, the ultimate determiner of the issue will be the Supreme Court." *Id.* at 436 n.157.

99. Although respondents have raised a panoply of constitutional challenges to administrative proceedings, the primary—and most successful—arguments to date have been predicated on Article II of the U.S. Constitution. Article II challenges have assumed two forms. First, respondents contend that "the SEC's ALJs are 'inferior officers' who must be appointed by the head of an executive department." *E.g.*, Stephen J. Choi & Adam C. Pritchard, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment* 13 (Law & Econ. Working Papers, Paper No. 119, 2016) http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1233&context=law_econ_current [https://perma.cc/Q43C-7WVA].

constitutional dispute, significant as it is, will not affect the debate about the fairness of the SEC's administrative procedures, because the constitutional controversy implicates the process by which ALJs are nominated and not the rules of procedure under which they operate. The concerns over the fairness of SEC administrative proceedings that animate proposals for reform will therefore survive any resolution of the constitutional controversy, as long as administrative actions continue in their current form.

## II. THE COMMISSION'S RESPONSE

The Commission is well aware of these criticisms, and has responded with two distinct strategies.

First, the Commission's Division of Enforcement has issued a statement identifying four factors that it considers when deciding whether to proceed through the administrative forum or in federal court: (1) "the availability of the desired claims, legal theories, and forms of relief in each forum"; (2) "whether any charged party is a registered entity or an individual associated with a registered entity"; (3) "the cost-, resource-, and time-effectiveness of litigation in each forum"; and (4) "the fair, consistent, and effective resolution of securities law issues and matters."[100] Critics have characterized the factors as "nonexhaustive, nonmandatory and unweighted," and as not placing any meaningful limit on the Commission's exercise of discretion.[101] Critics also contend that "any consideration of

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Second, respondents contend that "the SEC's ALJs are unconstitutional because they are insulated from oversight by the President by more than one layer of 'for cause' removal." *Id.* On August 9, 2016, the District of Columbia Circuit became the first appellate court to substantively address the constitutionality of the SEC's nomination of ALJs. *See* Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016). In *Lucia*, the court held that the SEC's use of ALJs is constitutional because ALJs are employees who lack the authority to issue "final decisions," rather than "[o]fficers" who must be appointed pursuant to the Appointments Clause of the United States Constitution. *Id.* at *5–7. With at least one similar case pending before the Tenth Circuit, *see* Bandimere, Securities Act Release No. 9972, Exchange Act Release No. 76308, 2015 WL 6575665, at *19 (Oct. 29, 2015), *petition for review filed*, No. 15-9586 (10th Cir. Dec. 22, 2015), the *Lucia* decision could set an important precedent in the constitutional debate, or it could lead to a circuit split that would have to be resolved by the Supreme Court. The decision also could bolster the SEC's reliance on its in-house tribunals, even in the face of increased attacks on the fairness of the administrative forum. For a discussion of some of the recent litigation and the constitutional challenges raised therein, see Platt, *supra* note 1 (discussing the constitutional challenges to administrative proceedings), and see also Thomas S. Glassman, *Ice Skating Up* Hill*: Constitutional Challenges to SEC Administrative Proceedings*, 16 J. BUS. & SEC. L. 47 (2015), and Zaring, *supra* note 9.

100. SEC, *supra* note 1, at 1–3.

101. *See, e.g.*, Thomas A. Hanusik et al., *What's Missing from the SEC's Forum Selection Guidance*, LAW360 (May 21, 2015, 10:34 AM), http://www.law360.com/articles/658532/what-s-missing-from-the-sec-s-forum-selection-guidance (suggesting that the guidance "missed a golden opportunity to make the forum selection process fairer to defendants") [https://perma.cc/7DKG-4TBV]; *SEC Enforcement Division Issues Guidance on Venue Selection*, LATHAM & WATKINS (May 18, 2015), https://www.lw.com/thoughtLeadership/lw-sec-guidance-choice-of-venue (observing that the guidance "basically affirms the SEC's view of the venue-selection process as subject to rather broad discretion without meaningful limitations") [https://perma.cc/M6L9-DRUL].

defendants' rights, beyond their impact on the SEC's costs, is glaringly absent" from the guidance.[102] Indeed, the Commission could, as a practical matter, bring many cases in either the administrative or federal forum while citing the same four factors as support for its decision.[103] As a practical matter, it is easy to understand why the Commission might not want to constrain its prosecutorial discretion. However, the price of this policy is inevitable (and understandable) criticism over the SEC's lack of precision in offering guidance.

Second, the Commission has amended its Rules of Practice,[104] primarily to allow for a limited number of depositions and to provide additional time for preparation in administrative proceedings.[105] With respect to depositions, the Commission's new Rules of Practice permit the staff and respondents to take up to three depositions each in single-respondent cases

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102. Hanusik et al., *supra* note 101.

103. *See, e.g.*, Randall J. Fons, *Administrative Proceedings vs. Federal Court: The SEC Provides Limited Transparency into Its Choice of Forum*, MORRISON FOERSTER (May 11, 2015), http://www.mofo.com/~/media/Files/ClientAlert/2015/05/150511SECChoiceofForum.pdf ("[W]ith the open-ended nature of the guidance, there is little to prevent the Division from choosing whatever forum it finds most advantageous.") [https://perma.cc/VHL7-RLMR].

104. *See generally* SEC Final Rules, *supra* note 55. For examples of critiques of the Commission's amended Rules of Practice, see Margaret A. Dale & Mark D. Harris, *SEC Adopts Amendments to Rules for Administrative Proceedings*, N.Y. L.J. (Aug. 10, 2016), http://www.newyorklawjournal.com/id=1202764688801/SEC-Adopts-Amendments-to-Rules-for-Administrative-Proceedings?slreturn=20160813160536 ("While providing additional safeguards, the amendments fall short of the broad procedural protections that defendants are afforded in federal court.") [https://perma.cc/UX3Z-8S8V]; *SEC Publishes Final Rules Amending the Rules of Practice for Administrative Proceedings*, JONES DAY (July 2016) [hereinafter JONES DAY], http://www.jonesday.com/sec-publishes-final-rules-amending-the-rules-of-practice-for-administrative-proceedings-07-19-2016/ ("The Commission's amended rules of practice for [administrative proceedings] are a step in the right direction, but they do not go nearly far enough to address the concerns underlying the continuing constitutional and legislative challenges to the Commission's administrative process.") [https://perma.cc/8LN5-HSHD]; CADWALADER, *supra* note 56 ("The amended Rules of Practice are a step in the right direction for administrative proceedings, but they are by no means equivalent to the degree of constitutional and procedural protections afforded civil defendants who find themselves in federal district court."); *see also Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part I*, SEC. DIARY (Oct. 8, 2015), http://securitiesdiary.com/2015/10/08/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-i/ ("[T]his proposal represents so feeble an effort at modernizing the Commission's dated Rules of Practice that only one judgment is justified. If the provision of fair and 'due' process to respondents in these actions is the standard, the Commission's grade is an 'F+.' If providing a reasoned and rational explanation for the proposals is the standard (i.e., do they pass muster under the Administrative Procedure Act), the Commission's grade is an 'F.'") [https://perma.cc/9MDP-EACL]; *Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part II*, *supra* note 61 (suggesting that the Commission's proposed discovery rule "provides a textbook case of arbitrary and capricious rulemaking"); Quaadman Comment Letter, *supra* note 61, at 7–8 (suggesting that the proposed three to five deposition limit is arbitrary and capricious because it "does not appear to be related to the number of persons that are deposed or interviewed in a typical investigation," "to the number of witnesses that the division staff typically calls in a litigated proceeding," or "to the type of misconduct that is alleged to have occurred").

105. *See generally* SEC Final Rules, *supra* note 55.

and up to five depositions each in multiple-respondent cases.[106] The Rules of Practice also allow each side to take two additional depositions upon a showing of compelling need.[107] Depositions are permitted only in the longest, most complex cases; parties in other types of proceedings are not permitted to notice depositions.[108]

Criticism of this new approach was swift and sharp.[109] To be sure, five or seven depositions are better than none, but critics ask where the magic numbers of five and seven come from. What is the basis for these limitations, or are they arbitrary and capricious?[110] And, not only are five and seven a small number of depositions in complex matters, "but figuring out which witnesses to depose may involve a large degree of guesswork if the agency took testimony from a number of people in its investigation, as is often the case."[111] Further, in cases involving multiple respondents, disputes can arise among the respondents as to which witnesses should be deposed: some witnesses are likely to be more helpful or damaging to some respondents than to others.[112] Instead of limiting the number of depositions according to a predetermined range, critics recommend that the Rules of

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106. *See id.* at *8–11. There is no separate provision for expert witness depositions. The three to five depositions permitted by the amended rules must therefore include both fact and expert witnesses. *Id.*

107. *See id.* at *10–11.

108. *See id.* at *9.

109. *See, e.g.*, JONES DAY, *supra* note 104 (noting that the "limits on depositions in the amended rules remain arbitrary and formulaic" and that "providing 'equivalent' discovery—such as the same number of depositions—to the respondent and to the Division of Enforcement during the pendency of an [administrative proceeding] does nothing at all to address the immense informational imbalance in the Commission's favor following the investigatory phase, when the Commission's power to discover and depose is virtually unlimited, while the respondent's ability to do the same hardly exists"); CADWALADER, *supra* note 56 (noting that "the limited number of depositions permitted is likely insufficient to have much impact on larger scale investigations involving numerous actors or multiple jurisdictions"). Some have critiqued the Commission's proposed amendments to Rule of Practice 233, which would have extended the number of depositions in complex cases to three for single-respondent cases and five for multirespondent cases without any opportunity to seek additional depositions. *See* Richard Foster, Senior Vice President and Senior Counsel for Regulatory and Legal Affairs, Fin. Servs. Roundtable, Comment Letter on Proposed Rule: Amendments to the Commission's Rules of Practice 3 (Dec. 4, 2015) [hereinafter Foster Comment Letter], https://www.sec.gov/comments/s7-18-15/s71815-7.pdf ("The restricted number of depositions for respondents is prejudicial.") [https://perma.cc/JMV2-H6R4]; Quaadman Comment Letter, *supra* note 61, at 6–9 (arguing that the proposed change in prehearing depositions is deficient in a number of respects and does not level the playing field); Henning, *supra* note 71 ("[A]llowing only three—or at most five—depositions seems like an artificially low limit that will not do much to aid those accused of a violation in a complex case."); *see also Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part II*, *supra* note 61 (arguing that the proposed rules "allow an arbitrary number of depositions that is divorced from any analysis of what cases really require, and from any recognition that these are far from 'one size fits all' cases").

110. *See supra* note 104.

111. Henning, *supra* note 71.

112. *See, e.g.*, JONES DAY, *supra* note 104 (noting that in multirespondent cases, "some respondents may find themselves left out, with no guaranteed method to explore the factual allegations against them").

Practice be flexible and give ALJs discretion to increase the number of depositions each party can take.[113]

In its defense, the Commission might observe that many other federal agencies do not permit any depositions as part of the hearing process[114] and that depositions are not available in criminal proceedings without a court order and only then in exceptional circumstances.[115] From this perspective, the Commission could be viewed as more accommodating than its peers. That defense does not, however, respond directly to the substance of the opposition's critiques: the number of permitted depositions remains arbitrarily small.[116]

The Commission also amended its Rules of Practice to lengthen the time period during which respondents can prepare for a hearing and take the depositions that the Commission now permits.[117] Administrative proceedings can "have multiple defendants and may involve hundreds of thousands of pages of documents related to numerous clients and transactions. Under the current rules, even the most complex matter must be decided within 300 days, with the hearing to begin only four months after filing the charges."[118] Under the new rules, a hearing can begin as late as ten months after the filing of the charges in the most complex matters.[119]

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113. *See, e.g.*, Aegis J. Frumento & Stephanie Korenman, Partners, Stern Tannenbaum & Bell, Comment Letter on Proposed Rule: Amendments to the Commission's Rules of Practice 2 (Dec. 4, 2015), https://www.sec.gov/comments/s7-18-15/s71815-11.pdf ("[R]ather than limit the number of permissible depositions by Rule, it would be fairer to empower the Hearing Officer to allow depositions in the interests of justice upon a proffer of need, even if it results in more than three or five.") [https://perma.cc/U5SB-5TU2]; *id.* at 3 ("[T]o give the Staff the same right to depositions as Respondents just perpetuates the one-sidedness of the Commission's administrative proceedings, under a false guise of even-handedness."); Theodore B. Olson, Partner, Gibson, Dunn & Crutcher LLP, Comment Letter on Proposed Rule: Amendments to the Commission's Rules of Practice 6–7 (Dec. 4, 2015) [hereinafter Olson Comment Letter], https://www.sec.gov/comments/s7-18-15/s71815-8.pdf [https://perma.cc/Y5FL-ERP8].

114. *See, e.g.*, Air Transp. Ass'n of Am., Inc. v. Nat'l Mediation Bd., 663 F.3d 476, 487 (D.C. Cir. 2011) (noting that "[d]iscovery typically is not available in APA cases"); Grant v. Sullivan, No. 88-0921, 1989 WL 1829075 (M.D. Penn. July, 27 1989) (noting "the absence of a discovery mechanism during agency proceedings in Social Security disability cases"); Geoffrey Heeren, *Shattering the One-Way Mirror: Discovery in Immigration Court*, 79 BROOK. L. REV. 1569, 1582 (2014) (noting that the governing rule in immigration proceedings "seems to only contemplate 'evidence depositions' to preserve testimony for a hearing, rather than 'discovery depositions' to learn about witnesses before trial").

115. *See* FED. R. CRIM. P. 15(a)(1) ("A party may move that a prospective witness be deposed in order to preserve testimony for trial. The court may grant the motion because of exceptional circumstances and in the interest of justice."); *see also* United States v. Kelley, 36 F.3d 1118, 1124 (D.C. Cir. 1994) ("[Rule 15] permits depositions in criminal cases to be taken only by order of the court, and then only in 'exceptional' situations."); United States v. Grado, 154 F. Supp. 878, 879 (W.D. Mo. 1957) ("Unlike the practice in civil cases in which depositions may be taken as a matter of right by notice without permission of the court, [Rule 15] permits depositions to be taken only by order of the court.").

116. *See supra* note 109 and accompanying text.

117. *See* SEC Final Rules, *supra* note 55.

118. Henning, *supra* note 71.

119. *See* SEC Final Rules, *supra* note 55, at *54. Prior to the recently adopted amendments to the SEC's Rules of Practice, Rule 360 required the Commission to designate the time period for preparation of the initial decision as either 120, 210, or 300 days from the

Again, while this extension of time is an advance over the current state of affairs, critics complain that the prehearing discovery period remains "extremely short,"[120] particularly when measured against the time periods involved in comparably complex federal litigation. These rule changes also do not address a fundamental asymmetry in the administrative process. As previously observed, the Commission's staff often will have had years with which to prepare its case and take witness testimony, while respondents remain subject to a "rocket docket"—though less "rocket" than in the past—that forces them to prepare for trial within a relatively short time frame.[121] Here too, critics recommend that the Rules of Practice permit the ALJ "to depart from the default timelines wherever the complexity or other circumstances of the case reasonably justify such a departure."[122]

In its defense, the Commission can continue to argue that respondent counsel can, on occasion, "shadow" the SEC's investigation and obtain additional information well before the issuance of the formal order

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date of service of the order instituting proceedings. *See* 17 C.F.R. § 201.360(a)(2) (2016); *see also supra* note 57. Under Amended Rule 360, the Commission must designate the time period for preparation of the initial decision as 30, 75, or 120 days from the completion of posthearing or dispositive motion briefing or a finding of a default. *See* 17 C.F.R. § 201.360(a)(2); *see also* SEC Final Rules, *supra* note 55, at *5. Amended Rule 360 also adjusts the time periods during which the administrative hearing must begin. *See id.* The newly extended ten-month prehearing period applies only to the 120-day proceedings. *See id.* The new rules provide for an outer limit of six months for the hearing to commence in less complex seventy-five-day matters, and an outer limit of four months in thirty-day matters. *See id.* at *6.

120. *See* Joshua M. Newville & Jonathan E. Richman, *SEC Adopts Amendments to Rules Governing Its Administrative Proceedings*, NAT'L L. REV. (July 14, 2016), http://www.natlawreview.com/article/sec-adopts-amendments-to-rules-governing-its-administrative-proceedings [https://perma.cc/N4BC-NKRN]. For criticisms directed at the Commission's proposed rule, which would have extended the prehearing discovery period in complex cases for up to eight months, see Foster Comment Letter, *supra* note 109, at 3, noting that the proposed time limit was "too short and unrealistic," and Henning, *supra* note 71, stating that "the time in which an administrative case would be completed is still fairly short."

121. *See supra* notes 57–58; *see also* CADWALADER, *supra* note 56 ("Additional prehearing preparation time and a limited ability to depose witnesses hardly compares to the fact that the Enforcement Division has virtually unlimited discovery opportunities during the course of an investigation (for example, during SEC investigative testimony, only the SEC counsel and the witnesses' counsel are present, and the target of the investigation cannot even attend—much less examine—a witness or object to the questions asked).").

122. *See e.g.*, Olson Comment Letter, *supra* note 113, at 3; *see also* JONES DAY, *supra* note 104 ("[D]ue process demands that procedural rules provide for the ability to tailor such limits to the facts and complexities of a particular enforcement action. This is especially true with many Commission enforcement actions, which can involve accounting, financial, and trading and markets issues far more intricate and complex than many cases litigated in federal court."); Quaadman Comment Letter, *supra* note 61, at 10–11 (recommending that the proposed language be revised to enable the ALJ, for good cause, to extend the period between the filing of the order instituting proceedings and the commencement of the hearing); David M. Zornow et al., Skadden, Arps, Slate, Meagher & Flom LLP, Comment Letter on Proposed Rule: Amendments to the Commission's Rules of Practice 4 (Dec. 4, 2015), https://www.sec.gov/comments/s7-18-15/s71815-6.pdf ("[D]ecisions as to the appropriate number of depositions and timing for the hearing should be left to the discretion of the adjudicators who are presumably most familiar with the issues and needs of any particular case.") [https://perma.cc/C9DH-8CCM].

instituting proceedings.[123] In these instances, the burden imposed by the SEC's timetable might not be as onerous as critics suggest. However, if the respondent is, for any reason, unable to effectively "shadow" the investigation,[124] the burden of even the new, lengthened timetable can be substantial. This distinction perpetuates, but ameliorates, a preexisting inequity in the Commission's hearing procedures: respondents who have the ability to "shadow" are less disadvantaged by the Commission's timelines and discovery restrictions than respondents who, for any reason, lack that capacity.

The Commission also amended its evidentiary rules to formally exclude "unreliable" evidence and to clarify that "hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair."[125] Commenters were quick to observe that this standard makes "what is already an unfair aspect of [administrative] proceedings even worse" by "codify[ing] the ALJ practice of treating investigative transcripts as a reliable form of 'sworn statement'" and by "codify[ing] the acceptability of hearsay evidence more generally, apparently without regard to a realistic examination of reliability."[126] Indeed, under the SEC's new rule, "some out-of-court statements, like the investigative testimony of witnesses, could be considered without having to call them to attend the hearing, which avoids the risk they might say something different or lose credibility on cross examination."[127] Even under the new rules, the small number of depositions available to respondents can be viewed as especially troubling in light of the prospect of dozens of potential investigative witnesses having their testimony admitted without the respondent having any right to depose or cross-examine, particularly in large, complex matters.[128] Commenters instead advocate for Rules of Practice that mirror the Federal Rules of Evidence with regard to the admission of hearsay.[129]

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123. *See* Ceresney, Remarks to the ABA, *supra* note 4.

124. *See supra* note 62.

125. SEC Final Rules, *supra* note 55, at *54.

126. *Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part IV*, SEC. DIARY (Dec. 3, 2015), https://securitiesdiary.com/2015/12/04/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-iv/ [https://perma.cc/E73T-CXAG].

127. Henning, *supra* note 71.

128. *See, e.g.*, Barry R. Goldsmith, *SEC Proposed Amendments to Rules for Administrative Proceedings*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 15, 2015), http://corpgov.law.harvard.edu/2015/10/15/sec-proposes-amendments-to-rules-for-administrative-proceedings/ ("[I]n complex cases, which the Commission has increasingly authorized to proceed in its in-house courts, three or five depositions per side could be woefully inadequate . . . the proposed changes deny respondents the ability to depose all critical witnesses in complex cases, which generally exceed three or five in total.") [https://perma.cc/2LHL-RAAM].

129. *See, e.g.*, Foster Comment Letter, *supra* note 109, at 3 (arguing that "[t]he admission of hearsay evidence should be consistent with the Federal Rules of Evidence"); Olson Comment Letter, *supra* note 113, at 8 ("[T]he Rules of Practice should prohibit the admission of hearsay, subject to the various hearsay exceptions recognized under the Federal Rules of Evidence."); *see also* Quaadman Comment Letter, *supra* note 61, at 11–12 (arguing that the proposed rule does not go far enough in restricting hearsay, and recommending that the proponent of hearsay evidence be required to justify its admission with factual evidence

The Commission defends its new approach by observing that its standard is consistent with the Administrative Procedure Act[130] and by expressing the view that "a case-by-case determination of the admissibility of hearsay evidence is more appropriate than the broad exclusionary rules and procedures" proposed by critics of the new rule.[131]

In the aggregate, as a leading legal columnist writing for the *New York Times* has observed, these measures are "at best small steps in responding to criticism about truncated rights."[132] To be sure, the Commission can respond to these criticisms by further liberalizing its rules to allow ALJs to set any number of depositions and to allow additional forms of discovery. The Commission also could lengthen the calendar for proceedings before ALJs, harmonize its evidentiary rules with the Federal Rules of Evidence, and do a better job of following its own internal guidelines regarding the resolution of appeals. But even if these reforms are forthcoming, critics are unlikely to be fully appeased.[133]

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establishing the "reliability of the proposed testimony and demonstrating that its admission will not abridge the opposing party's right to effective cross-examination").

130. *See* SEC Final Rules, *supra* note 55, at *26.

131. *Id.*

132. Henning, *supra* note 9.

133. In addition to the changes already noted, the Commission's new Rules of Practice alter the requirements for serving an order instituting proceedings (OIP) on a person in a foreign country (Rule 141); "allow a stay pending Commission consideration of settlement offers to also stay the timelines set forth in Rule 360" (Rule 161); "allow the Commission or a hearing officer to exclude or summarily suspend a person for any portion of a deposition, as well as the proceeding, a conference, or a hearing" (Rule 180); require a respondent to state in its answer to an OIP "whether the respondent is asserting any avoidance or affirmative defenses, including but not limited to res judicata, statute of limitations, or reliance" (Rule 220); add depositions, expert witness disclosures or reports, the timing for completion of production of documents, and the filing of any dispositive motion pursuant to Rule 250 to the list of subjects to be discussed at the prehearing conference (Rule 221); require a party calling an expert witness to provide a brief summary of the expert's expected testimony, a statement of the expert's qualifications, a list of other proceedings in which the expert has opined during the previous four years, and a list of publications authored by the expert during the previous ten years (Rule 222); "provide that the Division may redact certain sensitive personal information from documents that will be made available, unless the information concerns the person to whom the documents are being produced," and "to clarify that the Division may withhold or redact documents that reflect settlement negotiations with persons or entities who are not respondents in the proceeding at issue" (Rule 230); adopt standards for a motion to quash or modify a subpoena (Rule 232); extend the maximum length of each deposition to seven hours (Rule 233); "provide that the moving party may take a deposition on written questions either by stipulation of the parties or by filing a motion demonstrating good cause" (Rule 234); permit parties, upon a motion, to introduce deposition testimony, investigative testimony, or certain sworn declarations (Rule 235); to amend the list of documents admissible as a prior sworn statement to include depositions taken pursuant to Rules 233 or 234, as well as investigative testimony and declarations taken under penalty of perjury pursuant to 28 U.S.C. § 1746, and to permit the use of statements made by a party or a party's officers, directors, or managing agents, and to clarify that such statements may be used by an adverse party for any purpose (Rule 235); permit three different types of dispositive motions to be filed at different stages of an administrative proceeding (Rule 250); adjust the timing of administrative proceedings by designating "the time period for preparation of the initial decision as 30, 75 or 120 days from the completion of post-hearing or dispositive motion briefing or a finding of a default" (Rule 360); and amend various appellate rules and guidelines. SEC Final Rules, *supra* note 55.

## III. THE DATA

Ideally, empirical analysis of the Commission's litigation performance would shed objective light on this debate and provide clear guidance as to whether and how administrative procedures should be reformed. Life is not so simple.

In particular, it is commonly argued that a comparison of the Commission's win-loss ratios in administrative proceedings and federal court litigation should provide constructive insight as to whether the Commission has a home-court advantage in administrative proceedings. A material portion of the empirical debate in this vein relies on data gathered by the *Wall Street Journal* suggesting that

> [t]he SEC won against 90% of defendants before its own judges in contested cases from October 2010 through March of [2015]. . . . That was markedly higher than the 69% success the agency obtained against defendants in federal court over the same period, based on SEC data.
> Going back to October 2004, the SEC has won against at least four of five defendants in front of its own judges every fiscal year.[134]

From these data, critics reason that the Commission does indeed have a home-court advantage and that it brings some actions in-house because it cannot win those cases in federal court.[135] These data also have been cited as evidence of bias in various constitutional challenges to the Commission's administrative law proceedings.[136]

The Commission has responded with vigor, describing these claims as "garbage" and stating "categorically that [it is] rubbish" to assert that the SEC is avoiding federal court because it has an advantage before ALJs.[137] Table 1 sheds light on this debate through an analysis of the outcomes in 100 litigated matters in fiscal years 2014, 2015, and 2016—through March 4, 2016. These litigated matters are limited to disputes in which the Commission seeks an original finding of a violation of the federal securities

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134. Eaglesham, *supra* note 78. Slightly different data are reported in other articles. *See, e.g.*, Jean Eaglesham, *Senior SEC Official Calls Claims of Advantage in In-House Tribunal "Garbage*,*"* WALL ST. J. (Feb. 19, 2016, 5:52 PM), http://www.wsj.com/articles/senior-sec-official-calls-claims-of-advantage-at-in-house-tribunal-garbage-1455922322 ("[T]he SEC won against 86% of defendants in contested cases in its own courts from October 2010 through September 2015—significantly higher than the agency's 70% win rate in federal court.") [https://perma.cc/QM9V-UFJN]; Mixter, *supra* note 88, at 73 (adjusting for decisions on appeal to the Commission, the SEC's success rate in 300-day administrative proceedings over the last ten years is approximately 91 percent).

135. *See, e.g.*, Eaglesham, *supra* note 78 ("An analysis by The Wall Street Journal of hundreds of decisions shows how much of a home-court advantage the SEC enjoys when it sends cases to its own judges rather than federal courts.").

136. These data have been "cited in numerous legal challenges to the SEC system." Eaglesham, *supra* note 134; *see also* Jean Eaglesham, *Federal Judge Rules SEC In-House Judge's Appointment "Likely Unconstitutional*,*"* WALL. ST. J. (June 8, 2015, 4:50 PM), http://www.wsj.com/articles/federal-judge-rules-sec-in-house-judges-appointment-likely-unconstitutional-1433796161 (observing that "Mr. Hill in his federal court challenge [to the constitutionality of administrative proceedings] cited a page-one article in The Wall Street Journal last month that showed the agency enjoys a significant home-court advantage when it sends cases to its own judges") [https://perma.cc/6WY6-HW49].

137. Eaglesham, *supra* note 78.

laws. Federal court subpoena enforcement proceedings, contempt proceedings, proceedings seeking freeze orders, and other similar actions are thus excluded from the analysis.[138] Including these actions in the analysis would substantially increase the Commission's measured success rate in federal court.

Table 1 measures outcomes in trials, summary judgments, and litigated admission settlements. A trial or summary judgment is deemed a victory for the Commission if the Commission prevails on one or more claims against any defendant in a manner that entitles the Commission to relief under the federal securities laws, even if no relief is ultimately awarded. A ruling or verdict for the Commission as to an element of an offense, absent a finding that a defendant actually violated a provision of the federal securities laws, is not counted as a Commission victory, because the Commission would still have to establish the fact of the violation. Litigated admission settlements arise when litigation is initiated (i.e., a complaint is filed without a simultaneous settlement), and the defendant later enters into a settlement in which the defendant admits to facts sufficient to constitute a violation of the federal securities laws. Situations in which the Commission initiates litigation and then resolves the matter with a "neither admit nor deny" settlement[139] are excluded from the analysis, as are cases that settle simultaneously with filing. The analysis in table 1 is on a per-case basis and does not measure outcomes by defendant.[140]

138. The following types of cases are excluded from this analysis: (1) cases that settle simultaneously with the filing of a complaint (even if admissions are obtained), (2) cases that settle with no admissions, (3) subpoena enforcement proceedings, (4) contempt proceedings, (5) cases that result in a default judgment, (6) 12(j) actions to delist a company, (7) follow-on administrative proceedings, and (8) cases predicated on collateral estoppel arising from a prior criminal conviction.

139. Jason E. Siegel, *Admit It!: Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Estoppel Effects*, 103 GEO. L.J. 433, 434 (2015).

140. Data suggest that the results are unlikely to differ materially if measured on a defendant basis. *See* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 968 (2016) (finding that the Commission prevailed against 95 percent of defendants in enforcement actions litigated in fiscal year 2010, but not subdividing the success ratio for administrative proceedings as opposed to federal court actions). Issues also arise with regard to measuring outcomes in the form of "cases." For example, in *SEC v. Wyly*, 56 F. Supp. 3d 394 (S.D.N.Y. 2014), one defendant settled with admissions several years after the initial complaint was filed. Final Consent Judgment as to Defendant Michael C. French, *Wyly*, 56 F. Supp. 3d 394 (No. 10-cv-5760). Two additional defendants proceeded to trial and were found liable on securities law claims. *See* Special Verdict Form, *Wyly*, 56 F. Supp. 3d 394 (No. 10-cv-5760). The *Wyly* fact pattern is counted as a litigated admission settlement and also as a trial victory. Thus, although initially filed as a single case, it is counted twice in table 1.

**Table 1**

**Panel (a): Litigated Outcomes Including Summary Judgments and Admission Settlements**

| Year | AP | DC | Total |
|---|---|---|---|
| FY 2014 | 14–0 (100%) | 22–8 (73%) | 36–8 (82%) |
| FY 2015 | 21–2 (91%) | 22–0 (100%) | 43–2 (96%) |
| FY 2016 (to 3/4/16) | 0–0 | 11–0 (100%) | 11–0 (100%) |
| Total (30 months) | 35–2 (95%) | 55–8 (87%) | 90–10 (90%) |

**Panel (b): Litigated Outcomes Including Summary Judgments but Excluding Admission Settlements**

| Year | AP | DC | Total |
|---|---|---|---|
| FY 2014 | 12–0 (100%) | 20–8 (71%) | 32–8 (80%) |
| FY 2015 | 19–2 (90%) | 20–0 (100%) | 39–2 (95%) |
| FY 2016 (to 3/4/16) | 0–0 | 10–0 (100%) | 10–0 (100%) |
| Total (30 months) | 31–2 (94%) | 50–8 (86%) | 81–10 (89%) |

**Panel (c): Litigated Outcomes Excluding Summary Judgments and Admission Settlements**

| Year | AP | DC | Total |
|---|---|---|---|
| FY 2014 | 12–0 (100%) | 11–7 (61%) | 23–7 (77%) |
| FY 2015 | 19–2 (90%) | 6–0 (100%) | 25–2 (93%) |
| FY 2016 (to 3/4/16) | 0–0 | 3–0 (100%) | 3–0 (100%) |
| Total (30 months) | 31–2 (94%) | 20–7 (74%) | 51–9 (85%) |

**Panel (d): Litigated Outcomes in Insider Trading Cases Only, Including Summary Judgments and Admission Settlements**

| Year | AP | DC | Total |
|---|---|---|---|
| FY 2014 | 0–0 | 4–6 (40%) | 4–6 (40%) |
| FY 2015 | 0–1 | 2–0 (100%) | 2–1 (67%) |
| FY 2016 (to 3/4/16) | 0–0 | 2–0 (100%) | 2–0 (100%) |
| Total (30 months) | 0–1 | 8–6 (57%) | 8–7 (53%) |

**Panel (e): Litigated Outcomes Excluding Insider Trading Cases, but Including Summary Judgments and Admission Settlements**

| Year | AP | DC | Total |
|---|---|---|---|
| FY 2014 | 14–0 (100%) | 18–2 (90%) | 32–2 (94%) |
| FY 2015 | 21–1 (95%) | 20–0 (100%) | 41–1 (98%) |
| FY 2016 (to 3/4/16) | 0–0 | 9–0 (100%) | 9–0 (100%) |
| Total (30 months) | 35–1 (97%) | 47–2 (96%) | 82–3 (96%) |

These data suggest that there is no statistically significant difference between the SEC's success rate before ALJs and its success rate in federal court when summary judgments and admission settlements are included in the analysis.[141] By this metric, as described in panel (a) of table 1, the Commission's success rate is 95 percent in administrative proceedings and a statistically indistinguishable 87 percent in federal court proceedings. Including summary judgments but excluding admission settlements, as described in panel (b) of table 1, leads to similar results, with the Commission prevailing in 94 percent of administrative proceedings and in 86 percent of federal trials. Again, the difference is statistically insignificant.[142]

Only if summary judgments and admission settlements are excluded from the analysis does a statistically significant difference emerge. Then, as described in panel (c) of table 1, the Commission wins 94 percent of its administrative proceedings but only 74 percent of its federal court proceedings.[143] These data are comparable to the statistics reported by the *Wall Street Journal*.[144] However, from a defendant's perspective, a summary judgment loss is every bit as real as a trial loss. Indeed, a defendant's summary judgment loss could, if anything, be taken as a greater vindication of the SEC's claim because the court has ruled that no rational jury could find in defendant's favor.[145] From this perspective, it makes little sense to exclude cases in which the Commission prevails either by summary judgment or admission settlement. Accordingly, the data suggest that, in the aggregate, the Commission has no particular advantage or disadvantage in federal court or before an ALJ.

The data do, however, suggest that the Commission's success ratio in insider trading cases is far worse than in other forms of litigation. As documented in panel (d) of table 1, the Commission's win-loss record in federal court insider trading cases is eight to six, or 57 percent. These six losses constitute six of eight, or 75 percent, of all of the Commission's federal court losses over the measurement period. If insider trading cases are netted from the analysis, as in table 1 panel (e), the Commission's win-loss record in federal court becomes forty-seven to two, or 96 percent, and thirty-five to one, or 97 percent before ALJs. The Commission is then

141. The following tests of statistical significance are formally called two-sample test of proportions and are calculated using the stata command prtesti. *See prtest—Tests of Proportions*, STATA.COM, http://www.stata.com/manuals13/rprtest.pdf (last visited Nov. 19, 2016) [https://perma.cc/9HTG-MG7T].

142. For the statistics in panel (a), a two-sample test of proportions results in a p-value of 0.24, which is statistically indistinguishable from zero under conventional levels of statistical significance. For panel (b), the comparable p-value is 0.26.

143. The p-value of the two-sample test of proportions for the data in panel (c) is 0.03, which is statistically significant at the 95 percent confidence level.

144. *See supra* note 134 and accompanying text.

145. *See* Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 252 (1986) ("If the defendant in a . . . civil case moves for summary judgment or for a directed verdict . . . [the inquiry is] whether reasonable jurors could find by a preponderance of the evidence that the plaintiff is entitled to a verdict . . . .").

faring slightly better in administrative proceedings than in federal court, but this difference is again not statistically significant.[146]

This finding challenges the claim that the Commission has a home-court advantage before its ALJs and that it attempts to exploit this advantage. Indeed, if the enforcement division believed that it has the upper hand before ALJs, then it would have rationally filed these post-Dodd-Frank insider trading claims as administrative proceedings and not as federal complaints. The Commission's decision to file these cases in federal court is thus inconsistent with the hypothesis that the SEC steers its weaker cases to its administrative courts.

The question then arises as to why the Commission's track record in its insider trading litigation has been so uniquely poor. An analysis of this issue opens the door to a broader critique suggesting that win-loss data are, in general, unreliable guideposts by which to measure the fairness of the Commission's administrative proceedings.

As an initial proposition, insider trading cases that proceed to trial reflect a strong selection bias. The strongest cases are prosecuted criminally by the Department of Justice. Once the government wins those cases, the Commission can prevail in a civil follow-on action, but, given our counting rules, those "easy wins" are not scored as Commission victories.[147] At the other end of the spectrum, when the Commission has a strong civil case that does not attract criminal scrutiny, defendants will rationally settle by giving the Commission largely all the relief it seeks. The easy wins are thus off the table, and the cases that proceed to trial are likely to be the most contentious matters in which the Commission and defendants cannot agree on a settlement. These bargaining failures often result from differing expectations as to the outcome of the case once all of the evidence is presented and are more likely to arise when reasonable litigators can have differing views as to subjective factors, such as the credibility of witnesses, that can be outcome determinative in insider trading litigation.[148] Bargaining failures are also more likely to arise when there is uncertainty as to the definition of the law, as is the case in the law of insider trading, which is not statutorily defined and which is subject to ongoing dispute, most notably over the definition of the personal benefit test.[149]

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146. The p-value of the two-sample test of proportions for the data in panel (e) is 0.75, which is not statistically significant.

147. *See supra* note 138 (noting that follow-on administrative proceedings are excluded from the analysis in this Article).

148. *See* Lucian A. Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND J. ECON. 404, 404 (1984) (observing "how informational asymmetry influences parties' decisions, and how it might lead to parties' failure to settle"); Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267, 1327 (2006) (observing that "a lawsuit's settlement value can be influenced by differential expectations, by differential bargaining power (or perceptions of differential bargaining power), and by game-theoretic effects that can be difficult to estimate").

149. *See* Petition for Writ of Certiorari at i, Salman v. United States, 136 S. Ct. 899 (2015) (No. 15-628) ("Does the personal benefit to the insider that is necessary to establish insider trading under *Dirks v. SEC*, 463 U.S. 646 (1983), require proof of 'an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly

Further, the Commission's "zero-tolerance" approach to insider trading generates an institutional incentive to proceed even with weaker cases. Indeed, to maintain the integrity of this initiative, the Commission could rationally prefer a loss at trial, as a matter of principle, than a settlement of convenience that might signal a wavering commitment to its campaign against insider trading. The notion that difficult cases can proceed to trial on grounds of "principle," even if the rational economic decision is to settle, is also present on the defendant's side of the table. This dynamic is effectively illustrated by Mark Cuban's decision to reject a Commission settlement offer that would have cost a small fraction of Cuban's ultimate defense costs when he proceeded to defeat the Commission's insider trading claims in federal court.[150]

In addition, the Commission can point to recent litigation failures in the administrative forum as evidence that is inconsistent with the argument that it has a home-court advantage before ALJs.[151]

Selection effects of this sort are hardly rare in the empirical analysis of litigation outcomes and commonly make it difficult to interpret win-loss statistics.[152] Win-loss statistics also fail to adjust for each case's degree of

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valuable nature,' as the Second Circuit held in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, No. 15-137 (U.S. Oct. 5, 2015), or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?"); *see also* Carmen Germaine, *Appeals Courts Still Lost in Post-*Newman *Trading Muddle*, LAW360 (May 27, 2016, 11:48 PM), http://www.law360.com/articles/801331/appeals-courts-still-lost-in-post-newman-trading-muddle ("The First Circuit's Thursday decision upholding a Massachusetts attorney's conviction for trading on tips from a golf buddy widened a circuit split in the wake of the Second Circuit's Newman decision . . . .") [https://perma.cc/M6UV-FKGR]; Carmen Germaine, *Insider Trading Law Already Clear, Feds Tell High Court*, LAW360 (Aug. 2, 2016, 6:04 PM), http://www.law360.com/articles/824057/insider-trading-law-already-clear-feds-tell-high-court (noting the split between the Second and Ninth Circuits concerning application of the personal benefit test) [https://perma.cc/K2YJ-4HG8].

150. *See* Bebo Amicus Brief, *supra* note 92, at 2 ("Mark Cuban was lucky enough to have the resources to fight the SEC's defective action against him . . . . Nevertheless, the pressure to settle was enormous—the SEC offered to settle his case for a fraction of the amount that he spent to clear his name.").

151. *See, e.g.*, Bolan, Jr., Release No. 877, 2015 WL 5316569 (ALJ Sept. 14, 2015) (initial decision) (rejecting the SEC's interpretation of insider trading law and dismissing claims brought administratively against a former Wells Fargo trader), *review granted by* Ruggieri, Securities Act Release No. 9985, Exchange Act Release No. 76614, 2015 WL 8519533 (Dec. 10, 2015); Wolf, Release No. 851, 2015 WL 4639230 (ALJ Aug. 5, 2015) (declining to impose sanctions on administrative respondent after finding the respondent was liable for aiding and abetting and causing violations of the federal securities laws); Delaney II, Release No. 755, 2015 WL 1223971, at *57 (ALJ Mar. 18, 2015) (finding "that the Division did not establish that Yancey failed to supervise Delaney and Johnson," and declining to impose any sanctions as to Yancey).

152. These difficulties are most extensively developed in the literature that seeks to measure the implications of the Supreme Court's change in its articulation of the standards for the grant of a motion to dismiss. *See generally* David F. Engstrom, *The* Twiqbal *Puzzle and Empirical Study of Civil Procedure*, 65 STAN. L. REV. 1203 (2013) (offering a critical assessment of the large body of empirical scholarship examining the effect of the Supreme Court's decisions in *Bell Atlantic v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009), on judicial and litigant behavior); Jonah B. Gelbach, *Material Facts in the Debate over* Twombly *and* Iqbal, 68 STAN. L. REV. 369 (forthcoming 2016) (measuring

difficulty. Consider, for example, the win-loss record that results if each case brought before an ALJ is a relatively straightforward matter in which the Commission clearly has the upper hand. A high win percentage for the Commission in its home court would then not be evidence of bias at all. It would, instead, be evidence that the Commission brings strong cases in the administrative venue. Simple win-loss data also fail to measure the extent to which the Commission receives the relief it seeks. The Commission can, for example, prevail on all substantive claims in an administrative proceeding, yet fail to obtain any of the relief it sought.[153] While our methodology describes this outcome as a Commission victory, the SEC could rationally view it as a Pyrrhic victory, or a technical defeat, because of the ALJ's failure to impose any of the sanctions sought. Moreover, win-loss data treat all cases as equally significant, when they are not. Some litigated matters reflect small potatoes disputes that have no meaningful precedential effects, whereas others address major legal principles that can have broad ranging implications for large sectors of the markets. This failure to adjust for the practical significance of each trial result is yet another limitation of the win-loss mode of analysis.

Most significantly, perhaps, the Commission's historical practice of litigating against regulated entities before ALJs, and only rarely litigating matters not involving regulated entities before ALJs,[154] establishes the potential for a profound selection bias. The types of fact patterns, causes of action, and nature of defenses in these cases is likely to differ in a systematic manner that cannot be captured by win-loss statistics.

A focus on win-loss statistics also masks an elephant in the room. The vast majority of SEC enforcement actions, whether filed in federal court or as administrative proceedings, are settled simultaneously with the initiation of the action.[155] These settled actions do not enter into the win-loss calculations, yet the most significant effect of the SEC's actual or

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the impact on case quality resulting from the Supreme Court's decisions in *Twombly* and *Iqbal*, which required courts to apply a higher standard when adjudicating Rule 12(b)(6) motions).

153. *See, e.g.*, *Wolf*, 2015 WL 4639230 (finding respondent liable for aiding and abetting and causing violations of the federal securities laws, but declining to impose sanctions).

154. *See, e.g.*, SEC, *supra* note 1 ("Although the Commission also may bring actions against [regulated entities] in district court, certain charges and forms of relief applicable to registered entities and associated individuals are available only in the administrative forum . . . . When seeking such remedies, it is often a more efficient and effective use of limited agency resources to seek those remedies directly in an administrative proceeding. . . . In addition . . . Administrative Law Judges and the Commission develop extensive knowledge and experience concerning issues that frequently arise in matters involving registered entities or associated persons.").

155. *See, e.g.*, NYU POLLACK CTR. & CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY AGAINST PUBLIC COMPANIES AND THEIR SUBSIDIARIES: MIDYEAR FY 2016 UPDATE 5 (2016) ("In the first half of FY 2016, 98 percent of public company and related subsidiary defendants resolved SEC actions on the same day they were initiated [concurrent settlements]."); Jorge Baez et al., *SEC Settlement Trends: 2H12 Update*, NERA ECON. CONSULTING 2 (2013), http://www.nera.com/content/dam/nera/publications/archive2/PUB_SEC_Trends_Update_2H12_0113_final.pdf ("[T]he vast majority of cases [brought by the SEC] are settled.") [https://perma.cc/Z7QZ-RX8D].

threatened shift to administrative proceedings may be on the terms of the settlements generated in both federal and administrative proceedings.[156]

Indeed, the data show a recent, sharp increase in the percentage of settled SEC enforcement proceedings that were filed as administrative proceedings rather than in federal court. In particular, in fiscal years 2010 through 2013, "the SEC brought more than 65 percent of its actions against public company defendants in civil court," but fiscal years 2014 and 2015 "saw a dramatic shift . . . [as] the SEC's venue of choice became its administrative court," with the Commission bringing only 24 percent of its actions in federal court.[157] Some observers suggest that these and other data indicate that the "SEC's ability to extract settlements has increased with the flexibility to choose its forum provided by Dodd Frank."[158] While it is entirely true that the Commission can extract settlements in administrative proceedings far larger than the settlements available prior to the Dodd-Frank Act, it does not necessarily follow that the Commission is using the administrative forum as a vehicle in which to bring weaker cases or in which to extract higher settlements, all other factors being equal (although they are not).

Instead, defendants in SEC proceedings could rationally prefer to settle matters in the administrative forum because the stigma associated with a settled administrative proceeding, which typically gives rise to an administrative cease-and-desist order, could be viewed as being less serious than the stigma associated with a settled federal proceeding, which typically gives rise to a federal injunction. Also, by settling in an administrative forum, both the Commission and the respondent eliminate the risk that the federal court judge reviewing the settlement might raise objections to a bargain that is entirely acceptable to both litigants.[159] Thus, a finding that

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156. *See infra* note 158.

157. *See* NYU POLLACK CTR. & CORNERSTONE RESEARCH, *supra* note 35, at 6.

158. Choi & Pritchard, *supra* note 99, at 39 ("[T]he shift toward administrative proceedings has been accompanied by a substantial increase in the SEC's leverage in administrative proceedings. The average civil penalty imposed on nonfinancial public companies named as defendants has increased, both in court and in administrative proceedings. We also show a significant increase in the incidence of cooperation with the SEC, particularly for administrative proceedings.").

159. *See, e.g.*, Siegel, *supra* note 139, at 446 ("Particularly at a time when federal judges have been questioning or rejecting settlements negotiated between defendants and the Enforcement staff, the agency has significant incentive to eschew federal court altogether and instead finalize settlements by Commission order."); Peter J. Henning, *Behind Rakoff's Rejection of Citigroup Settlement*, N.Y. TIMES: DEALBOOK (Nov. 28, 2011, 5:14 PM), http://dealbook.nytimes.com/2011/11/28/behind-judge-rakoffs-rejection-of-s-e-c-citigroup-settlement/ (discussing Judge Jed Rakoff's rejection of an SEC settlement with Citigroup over the bank's sale of mortgage-backed securities) [https://perma.cc/JMF7-PQD4]. Defendants also may prefer to resolve their claims in the administrative forum because the penalties for noncompliance with an administrative cease-and-desist order are less immediate than the penalties for noncompliance with a federal court injunction. A defendant who violates a federal court injunction can be found in contempt of court and can be fined, imprisoned, or subject to civil and criminal penalties. *See* Paul R. Berger et al., *The Total S.A. Action: Are Administrative Orders the SEC's FCPA Resolution of Choice for the Future?*, DEBEVOISE & PLIMPTON LLP FCPA UPDATE, July 2013, at 1, 5; *see also* 18 U.S.C. § 401 (2012) (providing U.S. courts the power to punish for contempt of court). If a

post-Dodd-Frank settlements imposing penalties on unregulated entities have migrated from the federal to the administrative forum may reflect defendant preferences as much as the exercise of applying enforcement discretion. This observation suggests the existence of a simultaneity issue that can vex the analysis of settlement data seeking to discern a cause-and-effect relationship resulting from the delegation of section 929P(a) of the Dodd-Frank Act.

Taken together, these observations urge extreme caution in interpreting win-loss data and settlement statistics in the debate over the fairness of the Commission's administrative proceedings. Commission opponents overstate their case by relying on the *Wall Street Journal* statistics, which omit summary judgments and admission settlements and fail to consider the differential results in insider trading prosecutions, as "evidence" that the administrative process is biased in the Commission's favor.[160] By the same token, Commission supporters overstate their case by pointing to statistically indistinguishable win-loss ratios in federal court and administrative proceedings as evidence that the Commission's administrative process is fair and needs no reform.[161]

Notwithstanding these statistical analyses, it cannot be denied that forum selection decisions can be outcome determinative. Two high-profile cases are sufficient to demonstrate this simple but central proposition. The Second Circuit's decision in *United States v. Newman*,[162] sharply limiting the nature of transactions that could be viewed as satisfying the *Dirks* personal benefit test,[163] would never have resulted from a Commission enforcement proceeding.[164] Similarly, many federal courts would never have agreed with the Commission's decision in *Flannery*,[165] which dramatically narrowed the reach of the Supreme Court's decision in *Janus Capital Group v. First Derivative Traders*[166] and asserted a muscular

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respondent violates an administrative cease-and-desist order, the SEC can immediately seek civil penalties for the violation. *See* 15 U.S.C. § 77t(d) (authorizing the Commission to seek civil penalties in district court for violation of a cease-and-desist order). However, if the SEC wishes to pursue contempt proceedings, it must first move a federal court to enter an injunction directing compliance with the order, then pursue contempt proceedings for noncompliance with the injunction. *See* Berger et al., *supra*, at 5 n.38 (explaining that 15 U.S.C. § 78u(e) grants "courts the authority to issue injunctions commanding persons to comply with the securities laws"). On the other hand, SEC administrative settlements, which are typically based on the SEC's "findings," can raise potential insurance coverage or licensing issues that federal court "allegations" do not. *See, e.g.*, In re Bebo *Shows Why SEC Administrative Proceedings Have Fairness Issues*, SEC. DIARY (Jan. 30, 2015), https://securitiesdiary.com/2015/01/30/in-re-bebo-shows-why-sec-administrative-proceedings-have-fairness-issues/ [https://perma.cc/4W4D-5NUB].

160. Eaglesham, *supra* note 78.

161. *See supra* note 141 and accompanying text.

162. 773 F.3d 438 (2d Cir. 2014).

163. The *Dirks* personal benefit test refers to the standard laid out in *Dirks v. SEC*, 463 U.S. 646 (1983).

164. *See supra* note 38.

165. Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Advisers Act Release No. 3981, Investment Company Act Release No. 31374, 2014 WL 7145625 (Dec. 15, 2014), *rev'd*, Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015).

166. 564 U.S. 135 (2011).

application of the *Chevron* deference doctrine to the Commission's administrative decisions.[167] Thus, even if win-loss data show no statistically significant difference between outcomes in administrative and federal court proceedings, the forum selection decision is not a matter of indifference, particularly as to the interpretation of contentious areas of the law.

## IV. IMPLEMENTING A MECHANISM DESIGN SOLUTION THROUGH A SELECTIVE REMOVAL STATUTE

The debate over the proper allocation of SEC enforcement proceedings between administrative and judicial venues, and over the appropriate level of procedural safeguards in administrative proceedings, is evidently complex. The battling camps express extreme positions. While critics advocate reforms that would effectively eliminate administrative proceedings as a means of resolving many, or even most, disputes,[168] defenders hope that modest tweaks will forestall sweeping reforms.[169] This Article suggests a middle ground: a properly crafted removal statute can promote an optimal allocation of litigation between the administrative and federal forums, while simultaneously creating incentives for the SEC to reform its internal procedures in a manner that builds confidence that its internal procedures are, in fact, fair and efficient.

This proposal rests on the observation that it is possible, ex ante, to conclude that some cases should rationally be channeled to the administrative forum but that others are better resolved in federal court. Many cases, however, are not so easily categorized in advance. For these cases, there is a need for a mechanism that allows an objective third party—not the Commission itself—to determine whether the case should proceed in an administrative or federal forum. As explained in greater detail below, a carefully crafted discretionary removal statute can allow the federal courts to perform this filtering function in a manner that does not overburden federal dockets, does not inordinately delay the resolution of disputes, and provides incentives for the SEC to assure fairness and efficiency in its administrative proceedings.

The basic contours of such a statute are straightforward. As an initial matter, the statute would define a category of enforcement actions that are assigned to the administrative forum and as to which respondents would have no right to seek removal. For these cases, the current law regarding the Commission's ability to select a forum would remain unchanged. While reasonable observers can differ over the precise definition of cases that should be designated for this category, several guiding principles can inform this classification decision. In particular, cases that raise technical matters likely to be within the SEC's greater competence, cases that involve

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167. *See Flannery*, 2014 WL 7145625, at *18, *20–22 (noting disagreements with several district court decisions).

168. *See supra* note 23.

169. For a discussion of recently adopted amendments to the SEC's Rules of Practice, see *supra* Part II.

formalistic violations, cases in which the stakes at issue are relatively small, or cases that implicate the integrity of the Commission's internal processes (such as the right to appear before the SEC), could reasonably be assigned to this category.

The second category would be composed of enforcement actions that must be filed in federal court unless the defendant consents to proceeding in an administrative forum. Conceptually, these cases would implicate questions of fact or law that, on a categorical basis, are better resolved in federal district court. Defining this category in advance is more difficult than identifying a set of cases that can rationally be assigned to the administrative arena. Indeed, if this categorization decision is based exclusively on the empirical analysis presented in Part III of this Article—which is not the decision rule advocated by this analysis—then only insider trading litigation appears to present characteristics that would support a presumption that the litigation should be heard in federal court. However, reasonable arguments can be presented to support the conclusion that larger, more complex matters should also automatically be assigned to federal court. For example, cases seeking penalties or disgorgement in excess of a predetermined dollar amount, or involving a number of witnesses that exceeds a particular threshold, also might be required to proceed in federal court unless the defendant consents to an administrative proceeding.

The third category would be composed of cases as to which it is difficult to determine, on an a priori basis, whether they are better resolved in administrative proceedings or in federal court. These cases are, effectively, the residual that does not fit in either of the first two categories. For these cases, the statute would provide respondents with a right to petition a federal court for an order removing the case from the Commission's administrative proceedings and assigning it to federal court. The grant of the order would be at the discretion of the district court judge to whom the petition is assigned.

This process can be modeled on existing Federal Rule of Civil Procedure 23(f),[170] which creates a discretionary interlocutory appeal from a district court decision ruling on a motion for class certification. Indeed, the very rationale for the adoption of Rule 23(f) mirrors the rationale for the adoption of a removal statute. Rule 23(f)'s drafters recognized that the class certification decision can, as a practical matter, be outcome determinative without regard to the merits of the underlying action.[171]

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170. FED. R. CIV. P. 23(f).

171. Proposed Amendments to the Federal Rules of Civil Procedure, 167 F.R.D. 523, 565 (1996). Addressing proposed revisions to Civil Rule 23(f), the Advisory Committee noted that

> [a]n order denying certification may confront the plaintiff with a situation in which the only sure path to appellate review is by proceeding to final judgment on the merits of an individual claim that, standing alone, is far smaller than the costs of litigation. An order granting certification, on the other hand, may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability. These concerns can be met at low cost by

Granting the courts of appeal a discretionary right to engage in interlocutory review therefore promotes the interests of justice.[172] By the same token, if there is concern that the decision to proceed as an administrative matter is also outcome determinative, then it is also reasonable to provide for a third party review of that decision. The most reasonable third party reviewer is the federal district court that would hear the matter if it was not committed to the administrative process.

The district court's decision whether to grant the proposed removal petition should not be standardless. To provide guidance for court and litigants, the statute could define a set of "core factors" that would govern the district court's consideration of removal motions, much as the courts have evolved "core factors" that govern Rule 23(f) proceedings.[173] These factors might include (1) whether the presence of a jury or of an Article III judge as a fact-finder would materially promote the interests of justice; (2) whether the litigation involves a level of factual complexity that is more equitably resolved through the application of the discovery and evidentiary rules applied in federal court than through the application of the procedural rules that govern the Commission's administrative proceedings; (3) whether the litigation involves the application of a substantively complex regulatory regime that is better addressed by an ALJ than by a jury or by an Article III judge; (4) whether the implications of the remedy sought by the Commission are sufficiently substantial that federal court proceedings are more appropriate; (5) whether the litigation presents questions of law that would benefit from resolution by the federal judiciary, rather than by the Commission seeking *Chevron* deference to its interpretation of the federal securities laws; (6) whether the respondent is a regulated entity; and (7) whether the federal court's docket is such that the efficient administration of justice calls for resolution of the matter in the administrative forum.

Simply articulating a three-part statutory categorization along with "core factors" to guide the courts in exercising their removal discretion in the third category of litigation would be insufficient to operationalize the statute because a host of technical matters remain to be addressed. In particular, the statute would have to (1) designate a time period within which the petition would have to be filed, (2) identify the district court(s) in which petitions may be filed, (3) explain whether administrative proceedings are stayed while the district court considers the petition, (4) explain whether a petition is deemed denied or granted if the district court fails to reach a decision within a stated time period or whether the district court has an unlimited time period during which to consider a petition, and (5) address whether there is a presumption for or against granting the

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> establishing in the court of appeals a discretionary power to grant interlocutory review in cases that show appeal-worthy certification issues.

*Id.*

172. *Id.*

173. For an example of a discussion of the core factors applied in the consideration of petitions invoking Rule 23(f), see Tanner Franklin, *Rule 23(f): On the Way to Achieving Laudable Goals, Despite Multiple Interpretations*, 67 BAYLOR L. REV. 412, 417–430 (2015).

petition or whether no such presumption exists. The resolution of these technical considerations could obviously have an important influence on the frequency with which removal petitions might be granted. For example, if the statute establishes a presumption against the grant of a petition and states that petitions shall be deemed denied unless granted within four weeks of filing, then the probability of removal would be lower than if the statute establishes a presumption in favor of the grant and states that the petition shall be deemed granted unless denied within four weeks of filing. The devil, as is often the case, is in the details.

It bears emphasis that the goal of this discretionary removal provision is not to cause a massive migration of litigation from the SEC's administrative process to the federal courts. The discretionary removal statute contemplated by this proposal can be crafted so that its primary effect is to present the SEC with powerful incentives to reform its internal procedures so that the federal courts do not feel compelled to grant removal petitions with great frequency. Indeed, to the extent that a removal statute stimulates the Commission to reform its internal processes so that they are perceived as fair and efficient by the courts and by Congress, and not just by the Commission, removal legislation can promote the interests of justice without overburdening the federal court dockets.

## CONCLUSION

The Commission faces a storm of criticism over the fairness of its internal administrative proceedings. It also faces criticism over its efforts to expand the number of cases brought as administrative proceedings and not filed in federal court. This criticism is amplified by concern that the SEC seeks to control the evolution of the federal securities laws by insisting on *Chevron* deference to its litigated administrative decisions while simultaneously limiting the number of occasions on which the federal courts will be able to interpret federal securities laws.

The Commission can respond to many of these concerns by changing its internal policies, and recently adopted amendments to the Commission's Rules of Practice[174] indicate that the Commission is not deaf to these concerns. But these internal reforms may be insufficient to address broader concerns over the operation of the Commission's administrative proceedings. Properly designed legislation that grants respondents in some SEC enforcement proceedings the right to petition for removal to federal court can provide powerful incentives for the Commission to reform its internal procedures so that they are perceived as fair and efficient by Congress and the courts, not just by the Commission. The same legislation can also clearly define categories of cases that must be filed as administrative proceedings and cases that must be brought in federal court, thereby further reducing concern that the Commission is directing litigation to the administrative forum for an improper purpose. Properly structured, such a discretionary removal statute may well be the best available design

174. *See* SEC Final Rules, *supra* note 55.

mechanism for resolving the current policy debate over the fairness and efficiency of the Commission's administrative proceedings.