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Ice Skating up *Hill*: Constitutional Challenges to SEC Administrative Proceedings

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ICE SKATING UP *HILL*:
CONSTITUTIONAL CHALLENGES TO SEC
ADMINISTRATIVE PROCEEDINGS

Thomas Glassman

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Abstract

Since the inception of the Dodd-Frank Act the Securities and Exchange Commission has come under fire for its increased use of administrative proceedings in adjudicating the agency's enforcement actions. That criticism has come to several suits in federal court claiming constitutional challenges to the system generally, and most recently, the Administrative Law Judges themselves. Until June of 2015, when Hill v. SEC took place in federal court, the Government was unbeaten when arguing against these constitutional challenges. Hill, however, found that it was likely the SEC had hired their Administrative Law Judges unconstitutionally. The SEC Administrative Law Judges have progressively been given more power through Congressional legislation and the question became whether these judges were mere employees, or inferior officers under the executive branch. While I think it is likely that an appellate court would uphold such an interpretation, I do not think it will lead to less SEC administrative proceedings and could potentially cause financial harm to those with cases currently pending in such a proceeding.

I. INTRODUCTION

For a March, 2015 article entitled "SEC's Admin Court Draws Fire From Every Angle," author Stephanie Russell-Kraft contacted United States Securities and Exchange Commission ("SEC") Spokesmen Judith Burns to ask if any of the numerous recent challenges to the SEC administrative proceedings has affected the agency's strategies when filing new enforcement actions.¹ Ms. Burns declined to comment, but instead referred the author to a November 2014 speech by SEC Enforcement Director Andrew Ceresney where he calls the agency's use of administrative proceedings "eminently proper, appropriate and fair to respondents."² After discussing the recent challenges, taking Mr. Ceresney at his word, Ms. Russell-Kraft ominously concludes that "[u]ntil a federal judge rules otherwise, it's still the SEC's game."³

¹ Stephanie Russell-Kraft, *SEC's Admin Court Draws Fire From Every Angle*, LAW360 (MARCH 2, 2015, 3:29 PM ET) <http://www.law360.com/articles/625254/sec-s-admin-court-draws-fire-from-every-angle>.

² *Id.*

³ *Id.*

Just two months later, Judge Leigh Martin May of the United States District Court for the Northern District of Georgia, Atlanta Division, ruled in favor of Charles L. Hill's preliminary injunction, which enjoined the SEC from proceeding with his "insider trading" in front of an SEC appointed Administrative Law Judge ("ALJ"). Judge May reasoned that because the ALJ was "not appropriately appointed" pursuant to Article II, Sec. 2, Cl. 2 of the United States Constitution ("The Appointments Clause") "his appointment is likely unconstitutional in violation of the Appointments Clause."⁴ In attempting to keep the judge from hearing the case at all, the SEC argued that the public interest should be in its favor because it is "charged with protecting investors and maintaining the integrity of the securities markets," but the court found that it is never "in the public interest for the Constitution to be violated."⁵

In this article, I try to put *Hill* in historical context by discussing prior caselaw and what it might mean for the SEC and respondents to Enforcement actions. I begin with the history of the SEC's authority and its ability to use administrative proceedings. I then discuss the advent of Dodd-Frank and the new abilities it gave the SEC to bring enforcement actions against non-registrants. Next, I discuss the differences between the SEC administrative proceedings and the federal court system and the common grievances since Dodd-Frank from law firms and academics about the SEC's use of administrative proceedings rather than Article III courts.

Then, I discuss the visible debate between District Court Judge Jed Rakoff and SEC Enforcement Director Andrew Ceresney. Next, I discuss the constitutional challenges, which have been brought in federal court and discuss each type of constitutional challenge and its efficacy. Then I go over the three cases since 2010 that have heard constitutional arguments: *Gupta*, *Duka*, and *Hill*. I discuss the full implications of the *Hill* case, which has potentially dangerous results for the SEC enforcement staff.

Finally, I discuss the hypothetical outcomes to federal courts agreeing with the ruling in *Hill*, why it might be only an ostensible problem for the SEC, and not as big a win for private parties fighting the SEC administrative system as may be originally thought. I conclude that that while the SEC would have to re-appoint (or more accurately appoint for the first time) its ALJs, this would not curtail its practice of using

⁴ *Id.*

⁵ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *19 (N.D. Ga. June 8, 2015).

administrative courts because all other Constitutional challenges in federal courts have been unsuccessful and parties whose cases were hypothetically invalidated would likely be retried in SEC administrative proceedings causing higher cost and potentially worse outcomes for respondents.

II. BACKGROUND

A. The SEC's authority: The first 50 years

The Securities Exchange Act of 1934 created the Securities and Exchange Commission and empowered the agency with broad authority over the United States securities industry.⁶ The SEC began with largely limited powers that consisted of seeking injunctions in federal district court for violations of the newly minted securities laws.⁷ The only express provision regarding administrative proceedings gave the SEC the ability to suspend or expel members or officers of national securities exchanges.⁸

Soon after its creation, the SEC "claimed inherent authority, subsequently approved by the courts, to suspend attorneys, accountants, and other professionals from practicing before it."⁹ Continuing over its first fifty years, the SEC:

obtained or asserted additional administrative powers, but in each instance, the expansion was tied to the agency's oversight of regulated entities or those representing those entities before the Commission, and even then was largely ancillary to the broader remedies and sanctions it could obtain only by going to federal court.¹⁰

For instance, "when Congress amended the securities laws in 1936 to require registration of brokers and dealers, it granted the [SEC]

⁶ See 15 U.S.C.A. § 78d.

⁷ Jed S. Rakoff, United States District Judge on senior status for the Southern District of New York, Keynote Address at the PLI Securities Regulation Institute: Is the S.E.C. Becoming a Law Unto Itself? (Nov. 5, 2014) (transcript available at <http://perma.cc/PM3Y-GWF9>).

⁸ *Id.* at 3.

⁹ *Id.*

¹⁰ *Id.*

the concomitant power to revoke registration as punishment for certain violations."¹¹ Similarly, "with the advent of registered securities associations in 1938, the SEC obtained the power to suspend or expel members of such associations in certain circumstances."¹² In 1964, this power "was extended to allow the [SEC] to suspend or bar regulated persons who violated the securities laws from associating with members of registered securities associations."¹³ With Congress' Insider Trading Sanctions Act of 1984, the SEC obtained "the power to order prospective compliance through injunctions, though only as to regulated persons and entities and only for certain violations of the securities laws."¹⁴ This marked the first instance where the SEC gained abilities that were "duplicative of the courts."¹⁵

B. SEC Authority Expanding: 1984 to today

In 1990, Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act ("PSRA").¹⁶ This legislation allowed the SEC to pursue "any person" for Exchange Act violations through an administrative cease-and-desist proceeding.¹⁷ In regards to SEC administrative proceedings, Congress gave the SEC the ability to seek disgorgement from any entity or person and the ability to fine regulated entities and persons.¹⁸ Importantly, these proceedings also allowed the SEC to obtain an order enjoining violations of the Exchange Act as well.¹⁹ In 2002, Congress, through the Sarbanes-Oxley Act, "granted the [SEC] the power to employ administrative proceedings to bar any person who had violated the securities laws from serving as an officer or director of a public company."²⁰

The Administrative law system was refined in 2010 when Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").²¹ Dodd-Frank allowed the SEC to seek

¹¹ *Id.* at 3-4.

¹² *Id.* at 4.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Pub. L. No. 101-429, 104 Stat. 931, 939 (1990).

¹⁷ See 15 U.S.C. § 78u-3.

¹⁸ Rakoff, *supra* note 7, at 5.

¹⁹ See 15 U.S.C. § 78u-3.

²⁰ Rakoff, *supra* note 7, at 5.

²¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

civil monetary damages from “any person” in an administrative hearing.²² This includes both those who are and are not registered with the SEC.²³ Until Dodd-Frank, the SEC could only seek civil penalties from registered individuals in an administrative proceeding.²⁴ Dodd-Frank also allowed the SEC to impose a monetary penalty against any person or entity, despite that violation being unintentional.²⁵ In essence, if the SEC wanted to pursue an unregistered individual for civil penalties before 2010, it could only do so in federal court where the individual could invoke their Seventh Amendment right to a jury trial.²⁶

As it stands currently, the Exchange Act authorizes the SEC to initiate enforcement actions against “any person” suspected of violating federal securities laws and gives the SEC sole discretion to decide whether to bring an enforcement action in federal court or an administrative proceeding.²⁷

C. The SEC and the administrative process

The Administrative Procedures Act (“APA”) authorizes executive agencies to conduct administrative proceedings before an Administrative Law Judge (“ALJ”).²⁸ The SEC’s Rules of Practice provide that the SEC “shall” preside over all administrative proceedings whether by the Commissioners handling the matter themselves or delegating the case to an ALJ.²⁹ If the SEC chooses to have an ALJ preside over the case, it is done so by the Chief Administrative Law Judge.³⁰ The ALJ then presides over the matter, including the evidentiary hearing, and issues an initial decision.³¹ The SEC may, on its own motion or at the request of a party, order interlocutory review of any

²² See 15 U.S.C. § 78u-2.

²³ *Id.*

²⁴ Gupta v. S.E.C., 796 F. Supp. 2d 503, 507 (S.D.N.Y. 2011).

²⁵ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 929P(a).

²⁶ Hill v. S.E.C., 1:15-CV-1801-LMM, 2015 WL 4307088, at *2 (N.D. Ga. June 8, 2015).

²⁷ See 15 U.S.C. §§ 78u(d), 78u-1, 78u-2, 78u-3.

²⁸ 5 U.S.C. § 500, et seq.

²⁹ 17 C.F.R. § 201.100 (2015), et seq.

³⁰ *Id.*

³¹ 17 C.F.R. §201.360(a)(1) (2015).

matter during the administrative proceedings but “[p]etitions by parties for interlocutory review are disfavored.”³²

The initial decision can be appealed by either the respondent or the SEC’s Division of Enforcement.³³ Further, the SEC can review the matter “on its own initiative.”³⁴ If there is no appeal and the SEC elects not to review the initial order, the ALJ’s decision becomes “the action of the Commission”³⁵ and the SEC issues an order making the ALJ’s initial order final.³⁶

If the SEC grants review of the ALJ’s decision, it is *de novo* and it can permit the submission of additional evidence.³⁷ The evidence must be significant, however, as the SEC will accept the ALJ’s “credibility finding, absent overwhelming evidence to the contrary.”³⁸ The Commission “gives considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses’ testimony and observing their demeanor... Such determinations can be overcome only where the record contains substantial evidence for doing so.”³⁹

If, even after an ALJ’s initial decision is handed down, a majority of the participating Commissioners disagree with the outcome, the initial order “shall be of no effect, and an order will be issued in accordance with this result.”⁴⁰ If the individual is on the losing end of an ALJ’s initial ruling, and the Commissioners allow the outcome, he, she, or it may petition the federal court of appeals for review of the order in their home circuit or the D.C. circuit.⁴¹ The court of appeals has jurisdiction to “affirm or modify and enforce or to set aside the order in whole or in part.”⁴² The SEC’s findings of fact are “conclusive” “if supported by substantial evidence.”⁴³

³² 17 C.F.R. § 201.400(a) (2015).

³³ 17 C.F.R. § 201.410 (2015).

³⁴ 17 C.F.R. § 201.411(c) (2015).

³⁵ 15 U.S.C. § 78d-1(c) (2015).

³⁶ 17 C.F.R. § 201.360(d)(2) (2015).

³⁷ 17 C.F.R. §§ 201.411(a), 201.452 (2015).

³⁸ *In re Clawson*, Exchange Act Release No. 48143, 2003 WL 21539920, at *2 (July 9, 2003).

³⁹ *In re Pelosi*, Securities Act Release No. 3805, 2014 WL 1247415, at *2 (Mar. 27, 2014) (footnote and internal quotation marks omitted).

⁴⁰ 17 C.F.R. § 201.411(f) (2015).

⁴¹ 15 U.S.C. § 78y(a)(1).

⁴² 15 U.S.C. § 78y(a)(3).

⁴³ 15 U.S.C. § 78y(a)(4).

The SEC considers several factors in contested actions when choosing an adjudicative forum and has made their criteria public.⁴⁴ The SEC considers four factors, the first of which is the availability of the desired claims, legal theories, and forms of relief in each forum.⁴⁵ Second, the SEC considers whether any charged party is a registered entity or an individual associated with a registered entity.⁴⁶ Third, the SEC considers the “cost-, resource-, and time-effectiveness of the litigation in each forum.”⁴⁷ Finally, the SEC considers whether the forum will bring about “fair, consistent, and effective resolution of securities law issues and matters.”⁴⁸

⁴⁴ SECURITIES AND EXCHANGE COMM’N, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS 1 (2015) <http://perma.cc/QVQ2-AK9W>. The SEC does qualify their guidance with the following statement: “There is no rigid formula dictating the choice of forum. The Division considers a number of factors when evaluating the choice of forum and its recommendation depends on the specific facts and circumstances of the case. Not all factors will apply in every case and, in any particular case, some factors may deserve more weight than others, or more weight than they might in another case. Indeed, in some circumstances, a single factor may be sufficiently important to lead to a decision to recommend a particular forum. While the list of potentially relevant considerations set out below is not (and could not be) exhaustive, the Division may in its discretion consider any or all of the factors in assessing whether to recommend that a contested case be brought in the administrative forum or in federal district court.”

⁴⁵ *Id.* “Certain claims, theories, and relief are only available in one forum.”

⁴⁶ *Id.* “Registered entities and associated persons have long been subject to the Commission’s regulatory oversight, which has long included Commission administrative proceedings. Although the Commission also may bring actions against them in district court, certain charges and forms of relief applicable to registered entities and associated individuals are available only in the administrative forum. For example, associational bars and suspensions can only be imposed in an administrative proceeding. 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 rather than first commencing a district court action, seeking and obtaining a district court injunction, and then instituting a separate administrative proceeding seeking the remedies based on the injunction. In addition, as described below, Administrative Law Judges and the Commission develop extensive knowledge and experience concerning issues that frequently arise in matters involving registered entities or associated persons.”

⁴⁷ *Id.* “This factor incorporates consideration of the efficient and effective use of the Commission’s limited resources.”

⁴⁸ *Id.* “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,

i) The Differences between SEC Administrative Hearings and Article III Courts

SEC administrative proceedings are much different from those conducted by an Article III court. For instance, the Federal Rules of Civil Procedure and Evidence hold no weight outside of federal court proceedings; instead parties are subject to the SEC's rules of practice.⁴⁹ These rules, however, can be circumvented by an SEC order for an "alternative procedure" or by refusing to enforce a rule if the SEC determines "that to do so would serve the interests of justice and not result in prejudice to the parties to the proceeding."⁵⁰ In fact, "[a]ny evidence 'that can conceivably throw any light upon the controversy, including hearsay, normally will be admitted in an administrative proceeding.'⁵¹

Many traditional federal trial practices are different or missing completely from an SEC administrative proceeding. For example, respondents are generally barred from taking depositions under SEC Rules of Practice 233 and 234, and can obtain documents only through the issuance of a Subpoena under Rule 232.⁵² Also, counterclaims are not permissible in administrative proceedings.⁵³ Further, the rules do not have an equivalent of a federal 12(b) motion,⁵⁴ and there are no provisions for interrogatories.⁵⁵

Timing can also be much different from a federal proceeding. Following an "Order Instituting Cease-and-Desist-Proceedings," a hearing must occur within one to four months.⁵⁶ This is not to say that

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."

⁴⁹ 17 C.F.R. § 201.100(a).

⁵⁰ 17 C.F.R. § 201.100(c).

⁵¹ In re Ochanpaugh, Exchange Act Release No. 54363, 2006 WL 2482466, at *6 n.29 (Aug. 25, 2006).

⁵² Hill v. S.E.C., 1:15-CV-1801-LMM, 2015 WL 4307088, at *2 (N.D. Ga. June 8, 2015). *see also* 17 C.F.R. §§ 201.232-234.

⁵³ Hill v. S.E.C., 1:15-CV-1801-LMM, 2015 WL 4307088, at *2 (N.D. Ga. June 8, 2015).

⁵⁴ *Id.*

⁵⁵ Rakoff, *supra* note 7, at 7.

⁵⁶ 17 C.F.R. § 201.360(a)(2) (2015).

the SEC could not extend any time limit for “good cause,” but the SEC and its ALJs are warned to “adhere to a policy of strongly disfavoring such requests, except in circumstances where the requesting party makes a strong showing that the denial of the request of motion would substantially prejudice their case.”⁵⁷

III. REACTIONS TO DODD-FRANK

With all the differences between federal court proceedings and SEC administrative proceedings, private practitioners, who are not used to the administrative proceedings are unlikely to find them more favorable to their clients. When Dodd-Frank opened the door for many more securities law cases to be heard in SEC administrative proceedings, many practitioners began to let their feelings be known.⁵⁸

The SEC wasted no time in using Congress’ new legislation to begin to bring more cases in front of its own ALJs.⁵⁹ Andrew Ceresney, SEC enforcement director said in November of 2014 that “[t]here is no question that we are using the administrative forum more often now than in past years, largely because of efficiency.”⁶⁰ Administrative Proceedings also have been very favorable to the SEC by comparison to the cases brought in federal courts.⁶¹ In the twelve-month period ending in September of 2012, the SEC won seven of seven contested administrative proceedings, during that same time frame; the SEC won 67% of its federal trials.⁶² In 2013, it won nine of ten administrative proceedings and 75% of its federal trials.⁶³ In 2014, the SEC won six of six of its administrative proceedings and 61% (eleven of eighteen) of its federal trials.⁶⁴

⁵⁷ 17 C.F.R. § 201.161(a)-(b) (2015).

⁵⁸ Jean Eaglesham, *SEC is steering more trials to judges it appoints*, FINANCIAL TIMES (Oct. 21, 2014), <http://perma.cc/E3KC-E8B4>. “It’s fair to say it’s the new normal,” Kara Brockmeyer, head of the SEC’s anti-foreign corruption enforcement unit, told a legal conference in October of 2014, “Just like the rest of the enforcement division, we’re moving towards using administrative proceedings more frequently.”

⁵⁹ Staff, SEC Focus on Administrative Proceedings: Midyear Checkup, LAW360 (May 27, 2015, 10:25 AM ET).

⁶⁰ Hazel Bradford, *Firms oppose SEC’s internal enforcement process*, PENSIONS AND INVESTMENTS (Mar. 9, 2015) <http://perma.cc/4QV5-BPCP>.

⁶¹ Eaglesham, *supra* note 58.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

This recent streak of success, coupled with the agency bringing more cases in an administrative setting have led multiple stakeholders to complain that the SEC has an unfair advantage in matters brought before their own appointed ALJs. There has been plenty of speculation that the commission is opting for administrative proceedings more “because they’re being much more aggressive in their interpretations of the law, and they have a poor track record in federal court with their interpretations.”⁶⁵ Further, “[t]here is some sentiment, whether well-founded or not, among SEC defense lawyers that the SEC trial unit has a home-court advantage in administrative proceedings.”⁶⁶

Some are pushing the SEC for more specific guidelines for deciding whether to bring a case through an administrative proceeding or federal court. Taking note of the extremely high success rate of the SEC in administrative proceedings, practitioners have said clearer guidelines would help “avoid the perception that the commission is taking its tougher cases to its in-house judges, and to ensure that all are treated fairly and equally.”⁶⁷ Other practitioners see the recent backlash as an opportunity for the SEC to “make some policy decisions...It’s really important for people to think of procedural protections. It’s a very big concern because the deck is already kind of stacked against anyone who the SEC is going after.”⁶⁸

A. Administrative Creep

Judge Jed S. Rakoff of the Southern District of New York delivered what may have been the most scathing review of the SEC’s new use of administrative proceedings in his keynote address at the Practising Law Institute’s annual institute on securities regulation.⁶⁹ Judge Rakoff focused on the “dangers that seem...to lurk in the [SEC’s] apparent new policy of bringing a greater percentage of its significant enforcement actions as administrative proceedings.”⁷⁰ He believes that

⁶⁵ Bradford, *supra* note 60. The possibility of an administrative action can have the same practical effect of a court case on a private fund, which is likely to settle in order to protect its reputation, Mr. Hirsch noted.

⁶⁶ *Id.* Quoting Bradley Bondi, a former counsel to two SEC commissioners.

⁶⁷ *Id.*

⁶⁸ Bradford, *supra* note 60. Quoting former SEC official Hester Peirce, a senior research fellow at the Mercatus Center at George Mason University, Arlington, Va., who sits on the SEC investor advisory committee.

⁶⁹ Rakoff, *supra* note 7.

⁷⁰ *Id.* at 1.

under a “claim of greater efficiency” Congress has, at the request of the SEC, allowed the agency to obtain anything they might want without going to court “by tacking the provisions authorizing such expansion onto one or another statute enacted in the wake of a financial scandal.”⁷¹ The increased authority of the SEC coupled with its rise in administrative proceedings is, to Judge Rakoff, the perfect example of what he despairingly refers to as “administrative creep.”⁷²

According to Judge Rakoff, administrative creep, despite reducing the burden on federal judges, should concern the public and the judiciary because it “hinders the balanced development of the securities laws.”⁷³ In essence, if the SEC does not bring novel legal cases to federal court where the majority of past cases have been brought, but rather in administrative proceedings, “the result would be that the law in such cases would effectively be made, not by neutral federal courts, but by [SEC] administrative judges.”⁷⁴ This has led to surprising results such as the Second Circuit Court of Appeals overruling “its own prior interpretation of a novel 10b-5 issue, stating that “[t]he Commission has since issued a formal adjudicatory decision on the subject.... This later interpretation of Rule 10b-5 ‘trumps’ our prior interpretation.”⁷⁵

Judge Rakoff finishes his speech by alluding to potential constitutional issues administrative creep creates, saying “when it comes to interpreting the securities laws, a practical alternative – and the very one provided by the Constitution – has functioned very effectively for decades, namely, adjudication in the federal courts.... I see no good reason to displace that constitutional alternative with administrative

⁷¹ *Id.* at 5-6.

⁷² *Id.* at 6.

⁷³ *Id.* at 7.

⁷⁴ *Id.* at 10. Judge Rakoff explains that “This is because, at least in the case of administrative decisions that have been formally approved by the S.E.C., such decisions, though appealable to the federal courts of appeals, are presumed correct unless unreasonable. In other words, while the decisions of federal district courts on matters of law are subject to de novo review by the appellate courts, the law as determined by an administrative law judge in a formal administrative decision must be given deference by federal courts unless the decision is not within the range of reasonable interpretations. To put it in terms that this audience is familiar with, 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.”

⁷⁵ Rakoff, *supra* note 7, at 11. See *VanCook v. S.E.C.*, 653 F.3d 130, n.8 (2d Cir. 2011).

fiat.”⁷⁶ Amidst hostility from attorneys, companies, and the established legal community, the SEC needed to defend its position, which it did, sixteen days after the speech by Judge Rakoff.

B. Andrew Ceresney Responds

Andrew Ceresney, at the American Bar Association’s Business Law Section symposium, spoke at length on the criticism the SEC had been getting in regards to its increased use, and even the constitutionality of, administrative proceedings.⁷⁷ He spoke about the benefits to the SEC of using the administrative proceedings in lieu of the courts, and defended the SEC’s decision to use them against the recent condemnation the agency had been facing.

Mr. Ceresney listed three reasons why the SEC benefits from using administrative proceedings. First, because the administrative proceedings typically last under 300 days, the evidence does not become “stale” like it can in federal court proceedings.⁷⁸ “From the standpoint of deterrence and investor protection, I think we can all agree that it is better to have rulings earlier rather than later.”⁷⁹ Second, the administrative proceedings are decided using “specialized factfinders” who are experts in the types of “entities, instruments, and practices that frequently appear in our cases.”⁸⁰ Third, while ALJs are not obligated to follow the federal rules of evidence; their rules provide that they should “consider relevant evidence” and are therefore “guided by” the federal rules.⁸¹ Ceresney also mentioned that some proceedings, such as a “failure to supervise or causing violations” can only be brought in an

⁷⁶ Rakoff, *supra* note 7, at 12.

⁷⁷ Andrew Ceresney, Director, SEC Div. of Enforcement, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014). (transcript available at <http://perma.cc/C9HU-FB9V>).

⁷⁸ *Id.* “For cases we file in district court, we can often go 300 days and still be just at the motion to dismiss stage or part of the way through discovery, with any trial still far down the road. Proof at trial rarely gets better for either side with age; memories fade and the evidence becomes stale.”

⁷⁹ *Id.*

⁸⁰ *Id.* “Many of our cases involve somewhat technical provisions of the securities laws, and ALJs become knowledgeable about these provisions.”

⁸¹ *Id.*

administrative forum, which should be seen as a benefit to both parties, not just the SEC.⁸²

In regards to the timing of the recent disparagement of the SEC's administrative proceedings, Mr. Ceresney points out that "[c]ontrary to the impression some may have, we have been using administrative proceedings throughout the 42-year history of the Division of Enforcement, and the Commission used them even before its enforcement activities were consolidated in one division."⁸³ As to the recent criticism of the SEC use of administrative forums against unregistered entities and individuals, Ceresney said "ALJs call it like they see it, and I note that we have lost some significant proceedings before ALJs in the last few years....I would challenge anyone to identify a case in which an ALJ erroneously ruled for us where the Commission did not reverse the decision."⁸⁴

In respect to the SEC's recent upswing in administrative proceedings, Mr. Ceresney said that Congress gave them the ability to bring more cases in administrative proceedings with the arrival of Dodd-Frank allowed the SEC to "obtain penalties in administrative proceedings against unregistered parties comparable to those we already could obtain from registered persons."⁸⁵ This legislative change allowed the SEC to bring more cases to an ALJ, so according to Ceresney, "what we are doing now is simply making use of the administrative forum in cases where we previously could only obtain penalties in district court."⁸⁶

According to Ceresney, just because Dodd-Frank allows the SEC to bring more cases in an administrative forum that "does not mean that we will choose the administrative forum in every case."⁸⁷ For settled

⁸² *Id.* (internal quotations omitted). "I should note that these features of the administrative forum can also benefit the respondents. Either side can benefit when witnesses' recollections are fresher. And the relaxed rules of evidence may likewise give them more flexibility in offering evidence."

⁸³ *Id.* "SEC [ALJ]'s have adjudicated hundreds of enforcement matters over the years. Many of these cases were against regulated entities and individuals, and involved extensive factual records, complex and novel legal issues, and claims for significant financial penalties. So ALJs have been presiding over and adjudicating complex securities cases for decades."

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.* "there are situations where district court is the more appropriate forum. In certain cases, we need certain types of discovery that we can only get in district court. For example, where we file our case on an expedited basis to stop an ongoing fraud, a district court might be the only option that allows us to act

matters, he said, the decision is all about “efficiency,” and relieving the burden on the “competing demands of busy district court dockets.”⁸⁸ As for litigated cases, Ceresney says the SEC evaluates “each case to determine the appropriate forum based on the facts and circumstances.” And while there is “no question” that the SEC is using administrative proceedings more often, “actions we filed last year on at least a partially litigated basis, approximately 57 percent were filed in district court, and around 43 percent were filed in the administrative forum.”⁸⁹ “So we clearly are not shunning federal court in our litigated actions.”⁹⁰

Ceresney also spoke about some of the specific constitutional challenges that had been brought up about the agency’s administrative proceedings. First, he spoke on a “constitutional right to jury trial.”⁹¹ He simply stated that the Supreme Court had already considered and “rejected the argument that there is a Constitutional right to a jury trial for government claims based on statutes like the federal securities laws.”⁹²

On a potential due process violation involving lack of depositions and a perceived lack of transparency, Ceresney said that they have legal obligations to disclose information and that most respondents already know what the important evidence is “either because they produced it to us themselves, because it was testimony from their own

quickly while still being able to gather evidence. In certain cases, we need emergency relief, such as an asset freeze or receiver, and that requires an order from a district court. We also may believe that we can obtain summary judgment in district court. The bottom line is that we make a case by case determination of which forum is appropriate based on the particular facts of the case.”

⁸⁸ *Id.* Ceresney would also say that “This practice was recently endorsed by the Second Circuit Court of Appeals in the *Citi* decision, where the court noted that the Commission “is free . . . to employ its own arsenal of remedies” rather than bring settlements to district court.” *See SEC v. Citigroup Global Markets, Inc.*, 752 F.3d 285, 297 (2d Cir. 2014). It would seem that the SEC being “free” to use its arsenal may not have the public support Ceresney suggests.

⁸⁹ *Id.* Footnote 11 to the speech explains that “These numbers do not include certain types of actions including delinquent filings cases or follow-on administrative proceedings.”

⁹⁰ *Id.* *But see* SEC Focus on Administrative Proceedings: Midyear Checkup, LAW360 (May 27, 2015, 10:25 AM ET). <http://perma.cc/L9QP-PZ9V>. Which shows that enforcement actions filed in administrative proceedings have steadily rose from 63% in 2010 to 82% in in the first half of fiscal year 2015.

⁹¹ *Id.*

⁹² *Id.* *See* *Atlas Roofing Co., Inc. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 450 (1977).

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.”⁹³ Also, while “it is true that there generally are no depositions,” Ceresney “[does] not think that due process requires the ability to conduct depositions.”⁹⁴ He uses his experience as a former criminal prosecutor in comparing SEC Rule of Practice 233(b) to the federal rules of criminal procedure saying that the SEC is similar and “[i]f that approach is acceptable where someone’s liberty is on the line, then it is hard to see how due process requires more for respondents in administrative proceedings.”⁹⁵

Finally, in discussing the idea that administrative proceedings will “impair the proper development of the law,” a subject near and dear to Judge Rakoff, Ceresney comments that “using the administrative forum furthers the balanced and informed development of the federal securities laws, just as it does in other specialized legal areas in which administrative agencies function.”⁹⁶ He explained that the SEC commissioners review every ALJ decision de novo and that a party who disagreed with the decision is free to appeal the case in federal court “where panels of federal judges may have the final say on the

⁹³ *Id.* “We also have affirmative Brady obligations to disclose material, exculpatory information and Jencks Act obligations to turn over statements of our witnesses — neither of which apply in our district court proceedings. ALJs commonly require us to provide our witness lists and exhibit lists well in advance of the hearing, putting respondents on further notice about the specific content of our case.”

⁹⁴ *Id.*

⁹⁵ *Id.* “In a former life, I was a criminal prosecutor, and I saw many people sentenced to prison without any chance of deposing the government’s witnesses before trial.” *See* Fed. R. Crim. P. 15, “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.” *And See* SEC Rule of Practice 233(b) “Required finding when ordering a deposition. In the discretion of the Commission or the hearing officer, an order for a deposition may be issued upon a finding that the prospective witness will likely give testimony material to the proceeding; that it is likely the prospective witness, who is then within the United States, will be unable to attend or testify at the hearing because of age, sickness, infirmity, imprisonment, other disability, or absence from the United States, unless it appears that the absence of the witness was procured by the party requesting the deposition; and that the taking of a deposition will serve the interests of justice.”

⁹⁶ *Id.*

development of the law.”⁹⁷ He noted that the seminal cases *Cady Roberts* and *Dirks* both began in an administrative forum and went on to the federal courts.⁹⁸

“My bottom line is that, while we are using administrative proceedings more, we are still bringing significant numbers of contested cases in district courts...And our use of the administrative forum is eminently proper, appropriate, and fair to respondents.”⁹⁹

IV. CASES CHALLENGING THE ADMINISTRATIVE PROCEEDINGS USED BY THE SEC

Despite the back-and-forth in the court of public opinion, there have been several cases where respondents have questioned the SEC’s administrative authority on several levels. This article will focus on the issues of constitutionality and will attempt to catalogue the arguments and the responses from judges along with commentary from scholars and attorneys on those cases.

Some have seen the actions taken against the SEC as “misguided.”¹⁰⁰ Harvard Professor Adrian Vermeule observes that while he does not think the challenges will end any time soon, defendants may just have to get used to a “frustrating new reality.”¹⁰¹ Yale Professor Jonathan Macey, despite thinking the choice to bring some of the actions in administrative proceedings is “silly and stupid,” capitulates saying “[n]ot everything that is arbitrary and capricious is unconstitutional in a situation where massive amounts of discretion seem to be afforded to the administrative agency.”¹⁰²

⁹⁷ *Id.* “So the Commission has input on important questions, but legal rulings either supporting or reversing the Commission frequently are made at the circuit or Supreme Court level.”

⁹⁸ *Id.* See *Cady & Roberts & Co., Re*, 40 S.E.C. 907 (S.E.C. Release No. 1961) and *Dirks v. S.E.C.*, 463 U.S. 646 (1983).

⁹⁹ *Id.*

¹⁰⁰ Russell-Kraft, *supra* note 1.

¹⁰¹ *Id.* “When people are involved in a particular regulated industry or area, they take what’s always been done as a kind of baseline, and when Congress changes what has always been done, they think it’s suspect,” he said. “But from a constitutional standpoint, it isn’t necessarily.”

¹⁰² Russell-Kraft, *supra* note 1.

A. Constitutional Challenges in Federal Court. Step 1: Subject Matter Jurisdiction

While this article is meant to focus on the constitutional analysis of the SEC administrative process, it bears mentioning that whether the district courts have jurisdiction to hear these constitutional questions as a threshold matter is anything but settled. The SEC often argues that district courts lack jurisdiction to hear these types of cases.¹⁰³ Between March and July of 2015, five different cases were decided differently on the question of subject matter jurisdiction. *Hill* and *Duka* both found that the court did have jurisdiction over these sorts of constitutional questions, while *Tilton*, *Spring Hill Capital Partners*, and *Bebo* did not.¹⁰⁴ Interestingly, all of these courts relied on different interpretations of a three-part test from *Thunder Basin* in order to find whether review by a district court would be proper.¹⁰⁵ According to *Thunder Basin*, a court may presume that Congress does not intend to limit jurisdiction if (1) a finding of preclusion could foreclose all meaningful judicial review; (2) if the suit is wholly collateral to a statute's review provisions; and if (3) the claims are outside the agency's expertise.¹⁰⁶

Because the majority of cases found that they did not have subject matter jurisdiction under *Thunder Basin*, very few federal courts

¹⁰³ See *Duka v. U.S. S.E.C.*, No. 15 Civ. 357 (RMB)(SN), 2015 WL 1943245, at *3 (S.D.N.Y. Apr. 15, 2015). The SEC argued in *Duka* that “federal district courts lack jurisdiction over suits, like *Duka*’s, ‘that attempt to bypass an exclusive remedial [SEC] scheme established by Congress.’”

¹⁰⁴ Compare *Duka v. U.S. S.E.C.*, No. 15 Civ. 357 (RMB)(SN), 2015 WL 1943245, at *4 (S.D.N.Y. Apr. 15, 2015) (did find jurisdiction) and *Hill v. S.E.C.*, No. 1:15-CV-1801-LMM, 2015 WL 4307088, at *6 (N.D. Ga. June 8, 2015) (did find jurisdiction), with *Bebo v. S.E.C.*, No. 15-C-3, 2015 WL 905349, at *4 (E.D. Wis. Mar. 3, 2015) (did not find jurisdiction), *Tilton v. S.E.C.*, No. 15-CV-2472 RA, 2015 WL 4006165, at *13 (S.D.N.Y. June 30, 2015) (did not find jurisdiction), and *Spring Hill Capital Partners, LLC v. SEC*, No. 15-CV-4542 (ER) (S.D.N.Y. June 26, 2015) (did not find jurisdiction), ECF No. 24. Also See *Pierce v. S.E.C.*, 737 F. Supp. 2d 1068, 1075 (N.D. Cal. 2010) (did not find jurisdiction)(“Numerous courts have rejected similar efforts to enjoin SEC administrative proceedings, and held that parties must exhaust administrative remedies prior to seeking judicial review, including when the party seeking the injunction claims that the administrative proceedings violate due process.”).

¹⁰⁵ *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212-13 (1994). Also See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

¹⁰⁶ *Id.*

have evaluated the constitutional arguments. Since Dodd-Frank, the federal courts that found they did have subject matter jurisdiction, *Gupta*, *Duka*, and *Hill*, have decided very differently on the constitutional issues presented by the respondents in those SEC enforcement actions.¹⁰⁷ Many of the constitutional challenges in federal court, even those which were passed on as a jurisdictional matter, made strikingly similar constitutional challenges to the SEC's administrative forum. I will first discuss the arguments and their potential efficacy, then I will discuss *Gupta*, *Duka*, and *Hill* specifically.

B. Constitutional Challenges in Federal Court. Step 2: Constitutional Challenges

Somewhat frustratingly, the recent rash of constitutional challenges has not been reviewed for the most part because of federal courts claiming they do not have subject matter jurisdiction to hear them. Many of the arguments have been made multiple times and their efficacy is sure to be tested at a federal appeals court or the United States Supreme Court in the near future.¹⁰⁸ A discussion of the constitutional challenges decided upon by the federal courts is below, but first I will discuss the constitutional arguments being made and their potential likelihood of success.

i) *Due Process*

The argument for a violation of respondent's due process rights in the SEC's administrative proceedings has been raised several times. In its most basic form, the argument is that the SEC administrative proceedings do not afford defendants the same due process rights as the

¹⁰⁷ See *Gupta v. S.E.C.*, 796 F. Supp. 2d 503 (S.D.N.Y. 2011), *Duka v. U.S. S.E.C.*, 15 CIV. 357 RMB SN, 2015 WL 1943245 (S.D.N.Y. Apr. 15, 2015), and *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088 (N.D. Ga. June 8, 2015).

¹⁰⁸ Stephen M. Juris and Barrett Johnson, *Forum Over Substance? Respondent Rights And The SEC*, LAW360 (JULY 14, 2015, 10:30 AM ET) <http://perma.cc/A7WU-RGET>. "On June 4, [2015], the Seventh Circuit heard oral argument on one [case] pending appeal, and the SEC has appealed the Hill decision to the Eleventh Circuit. This holds out the possibility that at least some appellate guidance may be forthcoming in the not-too-distant future."

federal courts would and are therefore unconstitutional. The argument has taken several forms, which are discussed at length below.

Some respondents argue that their due process rights are violated because they are forced to complete an unconstitutional proceeding in order to appeal that proceeding's constitutionality.¹⁰⁹ Two of the three cases which found they did have subject matter jurisdiction to hear the constitutional arguments, *Duka* and *Hill*, found this argument compelling.¹¹⁰ A later case, *Tilton*, disagreed with their reasoning, not seeing anything inappropriate with the "congressionally-specified route of review" and agreeing with the reasoning of the *Bebo* court, which stated "[i]f the process is constitutionally defective, [the plaintiff] can obtain relief before the Commission, if not the court of appeals....Until then...the plaintiff must" await the conclusion of the administrative proceedings.¹¹¹ Indeed, successfully making this argument may be a prerequisite in order to convince a federal court they have jurisdiction over the constitutional challenges.

¹⁰⁹ See *Tilton v. S.E.C.*, No.15-CV-2472 RA, 2015 WL 4006165, at *6-7 (S.D.N.Y. June 30, 2015), *Chau v. U.S. S.E.C.*, 72 F. Supp. 3d 417 (S.D.N.Y. 2014), *Duka v. U.S. S.E.C.*, No. 15 Civ. 357 (RMB)(SN), 2015 WL 1943245, at *5 (S.D.N.Y. Apr. 15, 2015), *And Hill v. S.E.C.*, No. 1:15-CV-1801-LMM, 2015 WL 4307088, at *7 (N.D. Ga. June 8, 2015).

¹¹⁰ *Duka v. U.S. S.E.C.*, No. 15 Civ. (357 RMB)(SN), 2015 WL 1943245, at *5 (S.D.N.Y. Apr. 15, 2015) ("If Plaintiff were required, as the Government urges, to await the completion of the Administrative Proceeding to seek (any) judicial intervention, important remedies could be foreclosed. That is, her claim for injunctive and declaratory relief would likely be moot at that stage because the allegedly unconstitutional Administrative Proceeding would have already taken place. Simply put, there would be no proceeding to enjoin.") *and Hill v. S.E.C.*, No. 1:15-CV-1801-LMM, 2015 WL 4307088, at *7 (N.D. Ga. June 8, 2015) ("Plaintiff's claims go to the constitutionality of Congress's entire statutory scheme, and Plaintiff specifically seeks an order enjoining the SEC from pursuing him in its 'unconstitutional' tribunals. If Plaintiff is required to raise his constitutional law claims following the administrative proceeding, he will be forced to endure what he contends is an unconstitutional process. Plaintiff could raise his constitutional arguments only after going through the process he contends is unconstitutional—and thus being inflicted with the ultimate harm Plaintiff alleges (that is, being forced to litigate in an unconstitutional forum). By that time, Plaintiff's claims would be moot and his remedies foreclosed because the Court of Appeals cannot enjoin a proceeding which has already occurred.")

¹¹¹ *Tilton v. S.E.C.*, 15-CV-2472 RA, 2015 WL 4006165, at *7 (S.D.N.Y. June 30, 2015). *Citing Bebo v. S.E.C.*, 15-C-3, 2015 WL 905349, at *4 (E.D. Wis. Mar. 3, 2015).

Rakoff, as well as many defendants, have complained that certain guaranteed procedures in federal court (such as the right to take depositions, dismiss hearsay, relaxed speed requirements, etc.) are not available in administrative proceedings and therefore violate the respondents Due Process rights.¹¹² These claims have been less than compelling to federal judges outside of Judge Rakoff.¹¹³ Legal scholars, have also found this argument unappealing saying “[t]he bottom line is that nobody disagrees with the basic fact on the ground that Congress passed the statute to give the SEC the authority to bring these cases administratively.”¹¹⁴ Beyond this, if these arguments work there could be “massive collateral damage” as many agencies would be arranged unconstitutionally.¹¹⁵

ii) *Equal Protection*

An argument under the Equal Protection Clause typically involves the respondents claiming that the SEC arbitrarily chooses which forum to use or that the choice was made for discriminatory reasons by the agency.¹¹⁶ Legal scholars speculate that this argument’s best chance is if “the choice to bring an action on racial or other similar discriminatory grounds” or if the respondent is in a “true class of one case,”¹¹⁷ and only if it is raised “in the first instance before a pending proceeding.”¹¹⁸

A “class of one” claim takes place where the plaintiff is not a “protected class,” but rather when they are “intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment.”¹¹⁹ Only in *Gupta*, where 28 other members of the same insider trading ring were prosecuted in federal court and the respondent’s case was brought in an administrative proceeding, has this argument won favor in federal court.¹²⁰ However,

¹¹² Russell-Kraft, *supra* note 1. Also see Rakoff *supra* note 6, Chau v. U.S. S.E.C., 72 F. Supp. 3d 417 (S.D.N.Y. 2014), and Bebo v. S.E.C., 15-C-3, 2015 WL 905349, at *1 (E.D. Wis. Mar. 3, 2015).

¹¹³ Chau v. U.S. S.E.C., 72 F. Supp. 3d 417 (S.D.N.Y. 2014).

¹¹⁴ Russell-Kraft, *supra* note 1.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ 35 No. 1 Futures & Derivatives L. Rep. 1.

¹¹⁹ Chau v. U.S. S.E.C., 72 F. Supp. 3d 417, 431 (S.D.N.Y. 2014).

¹²⁰ Gupta v. S.E.C., 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011).

even if it is the case that the respondent finds other similar parties whose cases were brought in federal court this will not, in itself, carry the day.¹²¹

Even though the SEC's decision to bring one case one way and another case another way may seem arbitrary to defendants, the agency is fully within its rights to do so. "Once Congress has expressly given the SEC the authority to proceed in either forum, then the choice of forum is a matter of agency discretion."¹²² Further, the agency has released its approach to forum selection publicly where it considers a number of factors that lead to its decision of federal vs administrative courts.¹²³ As long as they can explain, based within those factors, why they chose a certain forum, it is unlikely a court will find the choice arbitrary where Congress specifically gave the SEC the ability to decide.

iii) *Jury Trial Right under the Seventh Amendment*

Prior to the passage of Dodd-Frank in 2010, the Exchange Act allowed the SEC to pursue unregistered individuals for civil penalties only in federal court where these individuals could invoke their Seventh Amendment right to jury trial.¹²⁴ The Exchange Act currently authorizes the SEC to initiate enforcement actions against "any person" suspected of violating the Act and gives the SEC the sole discretion to decide whether to bring an enforcement action in federal court or an administrative proceeding.¹²⁵

In order to successfully argue that the SEC administrative process violates a respondent's Seventh Amendment rights, you may have to choose a case where prior caselaw was built in front of a jury;

¹²¹ *Chau v. U.S. S.E.C.*, 72 F. Supp. 3d 417, 431 (S.D.N.Y. 2014). "As an initial matter, *Gupta* is distinguishable. That case involved an allegation of unequal treatment relative to twenty-eight comparator parties who allegedly participated in the same insider trading ring. *Harding and Chau*, by contrast, point to just three other cases, none of which involved the same underlying facts. In addition, assuming for the sake of argument that *Gupta* was decided correctly, this Court does not find *Gupta's* application of the *Thunder Basin* factors persuasive in these circumstances."

¹²² Russell-Kraft, *supra* note 1.

¹²³ SEC Division of Enforcement, *supra* note 44.

¹²⁴ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *2 (N.D. Ga. June 8, 2015).

¹²⁵ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *2 (N.D. Ga. June 8, 2015).

such as insider trading cases.¹²⁶ Insider trading cases have developed as common law and have not been expressly forbidden in any statute and therefore could be considered a private right, which would implicate the Seventh Amendment right to a jury trial.¹²⁷ However, the Supreme Court in *Atlas Roofing* seems to point in a different direction:

The point is that the Seventh Amendment was never intended to establish the jury as the exclusive mechanism for factfinding in civil cases. It took the existing legal order as it found it, and there is little or no basis for concluding that the amendment should now be interpreted to provide an impenetrable barrier to administrative factfinding under otherwise valid federal regulatory statutes.¹²⁸

Since Dodd-Frank, some respondents have attempted Constitutional challenges to the SEC's administrative forum based on their Seventh Amendment right, but none have been successful.¹²⁹ It was *Atlas Roofing* that convinced the court in *Hill* that Congress has the ability to create new public rights, which it did with Dodd-Frank, and the "Seventh Amendment is no bar to the creation of new rights or to their enforcement outside the regular courts of law."¹³⁰ In other words, "The fact that Congress previously required most of the SEC's cases to be

¹²⁶ Russell-Kraft, *supra* note 1. Quoting Victorine Froehlich, program chair of the New York City Bar Association's administrative law committee.

¹²⁷ *Id.* "In addition, under state law, liability has been imposed, for many years under a misappropriation of a corporate asset principle, underscoring that insider trading liability is a private right."

¹²⁸ *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 460 (1977).

¹²⁹ See *Bebo v. S.E.C.*, 15-C-3, 2015 WL 905349, at *1 (E.D. Wis. Mar. 3, 2015), *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *15 (N.D. Ga. June 8, 2015), and see *Chau v. U.S. S.E.C.*, 72 F. Supp. 3d 417 n.81 (S.D.N.Y. 2014). *Chau* attempted to roll his Seventh Amendment claim with his Equal Protection claim stating that "every other party who has been sued by the Commission in a case like this has had the "the right to a jury trial, the use of the discovery procedures available in federal court to shape their defense, the ability to challenge claims before trial that fail to satisfy rational pleading standards and the protections of the Federal Rules of Evidence to bar unreliable evidence."

¹³⁰ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *15 (N.D. Ga. June 8, 2015). *Citing Atlas Roofing Co., Inc. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 461 (1977).

brought in federal court shouldn't take away its ability to now change course."¹³¹

iv) Separation of Powers

The Separation of Powers Doctrine has been argued by respondents fighting the constitutionality of their SEC administrative proceedings.¹³² This argument is typically in the context of a potential Article II violation relating to the SEC ALJ's "tenure protection."¹³³ The form of the argument is that the administrative proceedings violate Article II because the judges are separated from Executive supervision by at least two layers of tenure protection.¹³⁴ This argument stems from *Free Enterprise*, a Supreme Court case that found it was a violation of the Separation of Powers doctrine to have more one "layer" of tenure protection between the Executive and its "officers."¹³⁵

First, unless the ALJs are considered "officers" of the Executive, than it does not matter because "employees can be separated from the executive without issue."¹³⁶ Several cases have argued that ALJs are officers, despite that the language of the *Free Enterprise* court seems to disagree.¹³⁷ Whether an ALJ is or is not an "inferior officers" of the

¹³¹ Russell-Kraft, *supra* note 1. Quoting Harvard Law Professor Adrian Vermeule.

¹³² The Appointments Clause also falls under the Separation of Powers Doctrine but is discussed below as it has been the only potentially successful challenge to the SEC administrative proceedings constitutionality.

¹³³ See *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *15 (N.D. Ga. June 8, 2015), *Duka v. U.S. S.E.C.*, 15 CIV. 357 RMB SN, 2015 WL 1943245, at *1 (S.D.N.Y. Apr. 15, 2015), and *Tilton v. S.E.C.*, 15-CV-2472 RA, 2015 WL 4006165, at *2 (S.D.N.Y. June 30, 2015).

¹³⁴ Russell-Kraft, *supra* note 1.

¹³⁵ *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 497 (2010).

¹³⁶ *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 506 (2010).

¹³⁷ *Id.* For similar reasons, our holding also does not address that subset of independent agency employees who serve as administrative law judges. See, e.g., 5 U.S.C. §§ 556(c), 3105. Whether administrative law judges are necessarily "Officers of the United States" is disputed. See, e.g., *Landry v. FDIC*, 204 F.3d 1125 (C.A.D.C.2000). And unlike members of the Board, many administrative law judges of course perform adjudicative rather than enforcement or policymaking functions, see §§ 554(d), 3105, or possess purely recommendatory powers. The Government below refused to identify either

Executive did not matter to the *Duka* court, which still found that “the statutory restrictions upon the removal of SEC ALJs are 'so structured as to infringe the President's constitutional authority.’”¹³⁸ The *Hill* court held that ALJs were indeed “inferior officers” and did not reach the issue of whether the ALJ’s two-layer tenure protection violated Article II, but the court did remark that it “has serious doubts that it does, as ALJs likely occupy quasi-judicial’ or ‘adjudicatory’ positions, and thus these two-layer protections likely do not interfere with the President's ability to perform his duties.”¹³⁹

v) *Non-Delegation Doctrine*

In *Hill*, the court makes quick work of a constitutional challenge to the SEC’s forum selection based on the “Non-Delegation Doctrine.”¹⁴⁰ Pursuant to the delegation Doctrine, Congress may delegate legislative decision-making power to agencies, but only if it “lay[s] down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform.”¹⁴¹ The respondent in *Hill* argued that Dodd-Frank “does not provide the SEC any criteria to make its forum selection decision.”¹⁴² The *Hill* court compared the SEC’s ability to choose a forum to a prosecutor being able to select between two statutes “which prevented identical conduct but provided different

“civil service tenure-protected employees in independent agencies” or administrative law judges as “precedent for the PCAOB.” 537 F.3d 667, 699, n. 8 (C.A.D.C.2008) (Kavanaugh, J., dissenting).

¹³⁸ *Duka v. U.S. S.E.C.*, No. 15 Civ. 357 (RMB)(SN), 2015 WL 1943245, at *10 (S.D.N.Y. Apr. 15, 2015).

¹³⁹ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *20 n.12 (N.D. Ga. June 8, 2015) *citing* *Duka v. U.S. S.E.C.*, 15 CIV. 357 RMB SN, 2015 WL 1943245, at *10 (S.D.N.Y. Apr. 15, 2015) *and also* *Humphrey's Ex'r v. United States*, 295 U.S. 602, 622, 55 S. Ct. 869, 871, 79 L. Ed. 1611 (1935).

¹⁴⁰ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *10 (N.D. Ga. June 8, 2015).

¹⁴¹ *Whitman v. Am. Trucking Associations*, 531 U.S. 457, 458, 121 S. Ct. 903, 905, 149 L. Ed. 2d 1 (2001) *citing* *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409, 48 S. Ct. 348, 352, 72 L. Ed. 624 (1928).

¹⁴² *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *10 (N.D. Ga. June 8, 2015).

possible penalties.”¹⁴³ The court concluded that because Congress, through legislation, has told the SEC which forum is appropriate, “It is for the enforcement agency to decide where to bring that claim under its exercise of executive power.... Because the SEC has been made aware of the permissible forums available under each statute, ‘Congress has fulfilled its duty.’”¹⁴⁴

V. GUPTA, DUKA, AND HILL: WHERE COURTS CONSIDERED THE CONSTITUTIONAL CHALLENGES

A. Gupta v. SEC

Rajat Gupta, a former board member for both Goldman Sachs and Procter and Gamble, “had in 2008–09 knowingly disclosed material, nonpublic information about these companies to Raj Rajaratnam, the (now-convicted) principal of Galleon Management, LP who then traded on the basis of Gupta’s inside information.”¹⁴⁵ Gupta’s complaint alleged that the SEC’s plan was to gain an unfair advantage by depriving Gupta of the Constitutional protections he would have had if the case were brought in federal court, including:

[F]ull discovery, application of the federal rules of evidence, the ability to assert third-party claims for indemnification and contribution, the ability to bring counterclaims against the SEC, and, most importantly, a right to a jury trial: all of which rights are being accorded to every other Galleon-related defendant except Gupta.¹⁴⁶

The Court held that it would not be “prudent to allow every subject of an SEC enforcement action who alleges ‘bad faith’ and ‘selective prosecution’ to be able to create a diversion by bringing a

¹⁴³ Hill v. S.E.C., 1:15-CV-1801-LMM, 2015 WL 4307088, at *12 (N.D. Ga. June 8, 2015) (citing U. S. v. Batchelder, 442 U.S. 114, 121, 99 S. Ct. 2198, 2203, 60 L. Ed. 2d 755 (1979)).

¹⁴⁴ Hill v. S.E.C., 1:15-CV-1801-LMM, 2015 WL 4307088, at *12 (N.D. Ga. June 8, 2015) (citing U. S. v. Batchelder, 442 U.S. 114, 126, 99 S. Ct. 2198, 2203, 60 L. Ed. 2d 755 (1979)).

¹⁴⁵ Gupta v. S.E.C., 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011).

¹⁴⁶ *Id.* at 508.

parallel action in federal district court.”¹⁴⁷ Judge Rakoff reasoned that it would be easy to dispel such frivolous cases under *Iqbal*.¹⁴⁸ But, because Gupta already had a “well-developed public record” of “being treated substantially disparately from 28 essentially identical defendants, with not even a hint from the SEC . . . as to why this should be so” the court held that Gupta would likely be successful in his Equal Protection claim.¹⁴⁹

Law firms, the academy, and the fourth estate would call this a huge loss for the SEC. One commentary wrote “In so deciding, Judge Rakoff served the SEC a number of strong blows, from questioning the SEC's motives when it filed an administrative proceeding against Gupta, to all but accusing the SEC of arbitrarily discriminating against identical defendants.”¹⁵⁰ The SEC would settle with Gupta, agreeing to drop the administrative proceeding if Gupta dropped his lawsuit in federal court,¹⁵¹ though the SEC did retain its ability to bring action against Gupta in federal court,¹⁵² which it did,¹⁵³ obtaining a \$13.9 million penalty against Gupta two years later.¹⁵⁴ The constitutional issues, including the likely successful Equal Protection claim, were never decided.

¹⁴⁷ *Id.* at 514.

¹⁴⁸ *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011) (citing *Ashcroft v. Iqbal*, 556 U.S. 662 (2009)).

¹⁴⁹ *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011).

¹⁵⁰ Leen Al-Alami, *Business Roundtable v. Sec: Rising Judicial Mistrust and the Onset of A New Era in Judicial Review of Securities Regulation*, 15 U. PA. J. BUS. L. 541, 543 (2013).

¹⁵¹ *Gupta v. SEC* 11 Civ. 1900 (JSR) (S.D.N.Y. Aug. 4, 2011) (available at <http://perma.cc/87TT-SYEC>).

¹⁵² In the Matter of RAJAT K. GUPTA, Order Dismissing Proceedings, ADMINISTRATIVE PROCEEDING File No. 3-14279 (Aug. 4, 2011) (available at <http://perma.cc/JK2H-YTGY>).

¹⁵³ SEC Staff, *SEC Files Insider Trading Charges against Rajat Gupta*, For Immediate Release 2011-22 (Oct. 26, 2011) <http://perma.cc/XU2Y-ESVC>.

¹⁵⁴ SEC Staff, *SEC Obtains \$13.9 Million Penalty Against Rajat Gupta*, For Immediate Release 2013-128 (July 17, 2013) <http://perma.cc/ML2A-Y9XG>. “In addition to imposing the financial penalty, the order issued today by the Honorable Jed S. Rakoff of the U.S. District Court for the Southern District of New York enjoins Gupta from future violations of the securities laws, and permanently bars him from acting as an officer or director of a public company and from associating with any broker, dealer, or investment adviser.”

B. Duka v. SEC

In *Duka*, a former manager at Standard and Poor's, Barbara Duka, brought an action against the SEC in federal court seeking an injunction from continuing the administrative proceeding it initiated against her for securities violations.¹⁵⁵ Duka alleged that the SEC's ALJs are "insulated unlawfully from oversight by the President who, under Article II of the Constitution, is vested with the 'executive power,' including the ability to hold executive officers accountable by removing them from office."¹⁵⁶ Specifically, Duka argued that under Article II, if an ALJ can only be removed from office for good cause, then the decision to remove that ALJ cannot be vested in other officials (in this case, the SEC Commissioners) who also enjoy "good-cause" protected tenure.¹⁵⁷ In other words, the commissioners of the SEC, who can only be removed for cause (first level), can only remove the ALJs for cause (second level), and that creates two levels of "good cause" tenure protection that is unconstitutional under *Free Enterprise*.¹⁵⁸

According to the court, Duka's Article II claim consists of two different elements; first, whether the SEC's ALJs are "inferior officers," and second, whether there are multiple levels of "tenure protections" shielding the ALJs from executive oversight.¹⁵⁹ First, although it speculates that the ALJs are "inferior officers," similar to Special Trial Judges in Tax Court, the *Duka* court concludes, "it need not resolve the issue of whether ALJs are inferior officers because...the statutory restrictions on ALJs removal from office are both appropriate and constitutional."¹⁶⁰

The court disagreed with Duka that the so-called "second layer of protection" prevents the executive branch from effectively overseeing the ALJs, concluding that the "same layer of good cause protection is provided for in the APA and applies to ALJs across numerous federal agencies."¹⁶¹ The court dismissed Duka's injunction for failure to demonstrate a likelihood of success on the merits of her claim and

¹⁵⁵ *Duka v. U.S. S.E.C.*, No. 15 Civ. 357 (RMB)(SN), 2015 WL 1943245 (S.D.N.Y. Apr. 15, 2015).

¹⁵⁶ *Id.* at *1.

¹⁵⁷ *Id.* at *7.

¹⁵⁸ *Id.* at *7. See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

¹⁵⁹ *Duka*, at *7-8.

¹⁶⁰ *Duka*, at *8 (citing *Freytag v. Comm'r.*, 501 U.S. 868 (1991)).

¹⁶¹ *Duka*, at *10.

therefore did not review whether there would be irreparable harm or whether the public interest weighs in her favor.¹⁶²

This opinion was interpreted as a win for the SEC, but some felt the opinion lacked the depth that would stop others from filing future complaints in federal court for constitutional issues.¹⁶³ Commentators said that it may well be that a proper, complete, and thorough argument along these lines can be made, “but it is not reflected in this opinion.”¹⁶⁴ Another author felt that while *Duka* achieved a “procedural victory,” it was a shallow one that did not help the case of those “troubled to find themselves battling the SEC enforcement staff before an administrative law judge employed by the SEC.”¹⁶⁵

C. *Hill v. SEC*

And then, as Judge Rakoff wrote in *Gupta* four years earlier, “a funny thing happened” on the way to the SEC’s forum of choice.¹⁶⁶ Charles L. Hill, an unregistered real estate developer, purchased a large quantity of stock in a company conspicuously before the consummation of a merger.¹⁶⁷ The SEC alleged that he had received inside information and served Mr. Hill with an order instituting cease-and-desist proceedings in the SEC’s administrative court.¹⁶⁸ Hill filed in federal court claiming three violations of the constitution if he were forced to

¹⁶² *Duka*, at *10. The ability to obtain a preliminary injunction is predicated on whether *Duka* “(1) is likely to succeed on the merits of her claim, (2) will suffer irreparable harm absent injunctive relief, and (3) the public interest weighs in favor of granting the injunction.” However, elements two and three are only relevant if the court concludes that the Plaintiff has demonstrated a likelihood of success.

¹⁶³ *In Duka v. SEC, SDNY Judge Berman Finds SEC Administrative Law Enforcement Proceedings Constitutional in a Less than Compelling Opinion*, SECURITIES DIARY (April 16, 2015) <http://perma.cc/4Y79-2R3J>. “The effort lacks the depth and studiousness of an opinion likely to persuade appellate courts, and possibly other district courts as well.”

¹⁶⁴ *Id.*

¹⁶⁵ Richard F. Albert, *Duka v. SEC Redux - SEC Holds Home Court Advantage for Another Round*, FORBES (April 23, 2015 at 9:59 AM EST) <http://perma.cc/LCK3-EMDY>.

¹⁶⁶ *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 506 (S.D.N.Y. 2011).

¹⁶⁷ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *1 (N.D. Ga. June 8, 2015).

¹⁶⁸ *Id.* at *4.

submit the administrative proceeding: (1) the proceeding violated Article II because the ALJs are protected by two layers of protections (similar to *Duka*) and that the ALJs were not appointed properly, (2) the authority that Congress delegated to the SEC to pursue cases before ALJs violates the delegation Doctrine in Article 1, and (3) the proceedings violated his Seventh Amendment right to jury trial.¹⁶⁹

First, the court denied Hill's claims based on the delegation Doctrine.¹⁷⁰ The court held that Hill's reading of *Chadha*, where he argues that "any SEC decision which affected a person's "legal rights, duties, and relations of persons—to include charging decisions which the Supreme Court has held involve prosecutorial discretion, . . . would be legislative actions," which cannot be delegated to the executive.¹⁷¹ The court found that *Chadha* stood specifically for "the basic proposition that when Congress acts pursuant to its Article I powers, the action is legislative" as opposed to Executive action (such as would be done by an executive branch agency, the SEC).¹⁷² The court found that Hill's argument does not comport with the Executive's "constitutional role in faithfully executing the laws" rather than being delegated a role similar to the legislature.¹⁷³

Second, the court denied Hill's claims based on the Seventh Amendment right to a jury trial.¹⁷⁴ The argument here was simple; Hill argued that the SEC's decision to prosecute the claims against him in an administrative proceeding, rather than federal district court, violated his Seventh Amendment right to jury trial.¹⁷⁵ Hill's arguments involved *Tull*, a United States Supreme Court case where the Court held the petitioner had a right to a jury trial because the government's claim for a

¹⁶⁹ *Id.* "ALJ James E. Grimes found on May 14, 2015, that he did not have the authority to address issues (2) and (3) and "doubt[ed] that [he had] the authority to address [] issue" However, he did deny Plaintiff's Article II removal claim on the merits."

¹⁷⁰ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *13 (N.D. Ga. June 8, 2015).

¹⁷¹ *Id.* at *12 (internal quotation marks omitted).

¹⁷² *Id.* at *12-13.

¹⁷³ *Id.* at *13. "Because Congress has properly delegated power to the executive branch to make the forum choice for the underlying SEC enforcement action, the Court finds that the Plaintiff cannot prove a substantial likelihood of success on the merits on his non-delegation claim."

¹⁷⁴ *Id.* at *15.

¹⁷⁵ *Id.* at *13.

civil penalty was similar to an action in debt.¹⁷⁶ The Court quoted *Granfinanciera*, which explains what it calls “familiar analysis”:

First, we compare the statutory action to 18th-century actions brought in the courts of England prior to the merger of the courts of law and equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature...The second stage of this analysis is more important than the first.... If, on balance, these two factors indicate that a party is entitled to a jury trial under the Seventh Amendment, we must decide whether Congress may assign and has assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as factfinder.¹⁷⁷

In *Hill*, despite the fact the SEC conceded that an enforcement action for civil penalties is “clearly analogous to the 18th-century action in debt,” and that “this remedy is legal in nature,” the court found in favor of the SEC’s argument that this was a “public rights” case and therefore the government is acting as a sovereign in the performance of its executive duties.¹⁷⁸ Public rights cases “arise between the Government and [citizens] subject to its authority 'in connection with the performance of the constitutional functions of the executive or legislative departments.'”¹⁷⁹ *Hill* attempted to argue that Seventh Amendment rights can only be taken away when Congress creates a “new” public right, but the court called this interpretation of prior caselaw “form over substance” and stated that *Hill* was defining “new” in a way that the Supreme Court did not intend.¹⁸⁰

¹⁷⁶ *Tull v. United States*, 481 U.S. 412, 423 (1987).

¹⁷⁷ *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 42 (1989).

¹⁷⁸ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *13 (N.D. Ga. June 8, 2015) “A civil penalty was a type of remedy at common law that could only be enforced in courts of law. Remedies intended to punish culpable individuals, as opposed to those intended simply to extract compensation or restore the status quo, were issued by courts of law, not courts of equity.”

¹⁷⁹ *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 457 (1977).

¹⁸⁰ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *14 (N.D. Ga. June 8, 2015).

Finally, the court held that the SEC ALJs were not “appropriately appointed” pursuant to Article II, and therefore their appointment was likely in violation of the Appointments Clause.¹⁸¹ In short, the court held that the SEC ALJs are “inferior officers” under *Freytag*, and therefore must be “appointed by the President, a court of law, or a department head.”¹⁸² ALJ Grimes, who would preside over Hill’s administrative proceeding, was not “appointed by the President, a department head, or the Judiciary,” and therefore he was not “appropriately appointed pursuant to Article II, [and] his appointment is likely unconstitutional in violation of the Appointments Clause.”¹⁸³

The SEC immediately announced its plan to appeal the ruling.¹⁸⁴ Even going so far as to say that it “had has no plans to change the way it appoints its judges while it waits for the solicitor general to approve the appeal to the Eleventh Circuit.”¹⁸⁵ The Commission remarked that this is especially the case when “the SEC has over 100 litigated proceedings at various stages of the administrative process and the ALJ scheme has been in use for seven decades and is grounded in a highly-regulated competitive service system that Congress created for the selection, hiring and appointment of ALJs in the executive branch.”¹⁸⁶

VI. WHAT ARE THE IMPLICATIONS OF HILL?

The *Hill* case has shown that, in plain black-and-white, that the SEC ALJ system can be interpreted as a constitutional violation, if only an “unduly technical” one.¹⁸⁷ The vast majority of the challenges to the SEC’s administrative system seem to be the established securities law cabal pushing back against their collective experience with the SECs administrative proceedings so far, losing.¹⁸⁸

¹⁸¹ *Id.* at *19.

¹⁸² *Id.* Citing *Freytag v. C.I.R.*, 501 U.S. 868, 111 S. Ct. 2631, 115 L. Ed. 2d 764 (1991) and U.S. Const. art. II § 2, cl. 2.

¹⁸³ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *19 (N.D. Ga. June 8, 2015).

¹⁸⁴ Russell-Kraft, *supra* note 1.

¹⁸⁵ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *19 (N.D. Ga. June 8, 2015); Russell-Kraft, *supra* note 1.

¹⁸⁶ *Id.*

¹⁸⁷ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *20 (N.D. Ga. June 8, 2015).

¹⁸⁸ Russell-Kraft, *supra* note 1. “When people are involved in a particular regulated industry or area, they take what’s always been done as a kind of

However, the Appointments Clause argument could have merit if more federal courts, like *Hill*, decide they have subject matter jurisdiction, and are willing to weigh the merits of the constitutional arguments. The SEC is in the process of appealing *Hill*, but even if the agency is successful or settles the case, the constitutional challenge regarding the Appointments Clause (and others) will be raised again.¹⁸⁹ What then, if the SEC ALJs are found to be “inferior persons” under the Constitution?¹⁹⁰

A. What if the SEC ALJs are seen as inferior officers?

First, if the SEC were to agree that their ALJs were “inferior officers,” how easy would it be to cure the problem of having never appointed one correctly? The *Hill* opinion itself suggests that “the ALJ's appointment could easily be cured by having the SEC Commissioners issue an appointment or preside over the matter themselves.”¹⁹¹ The problem may be that the delegation of appointment power is unconstitutional in most cases.¹⁹² Does this mean that the SEC is going to have to change the way that ALJs are hired? Not necessarily.

baseline, and when Congress changes what has always been done, they think it's suspect...But from a constitutional standpoint, it isn't necessarily."

¹⁸⁹ See *Hill v. SEC*, 15-12831 (11th Cir.).

¹⁹⁰ Less than a month after the *Hill* decision, the SEC submitted a brief explaining the agency's position that the “Appointments Clause Argument Fails Because SEC ALJ Are Not Inferior Officers Under Article II.” The SEC writes that “Assuming that Chief ALJ Murray was not hired through a process involving the approval of the Commissioners, her appointment was consistent with Commission ALJ's long-standing existence and function as Commission employees.” See *In the Matter of Barna Biotech, Inc., et al.*, DIVISION OF ENFORCEMENT'S BRIEF IN REPLY ON ITS MOTION FOR SUMMARY DISPOSITION File No. 3-16456. (July 6, 2015) (available at <https://perma.cc/K64D-YKGT>).

¹⁹¹ *Hill v. S.E.C.*, 1:15-CV-1801-LMM, 2015 WL 4307088, at *20 (N.D. Ga. June 8, 2015).

¹⁹² Chris Walker, *The SEC's Inferiority Complex*, by Kent Barnett. NOTICE AND COMMENT, YALE JOURNAL ON REGULATION (June 11, 2015). <http://perma.cc/MGE9-HU7T>. The argument could be made the SEC should have been playing it safe by appointing ALJs as the “inferior officers” according to the courts is getting rather lengthy: “district-court clerks, clerks within certain executive departments, assistant surgeons, cadet-engineers, election monitors, federal marshals, military judges, and general counsel for the Department of Transportation.”

The SEC could still attempt to cure a potential Appointments Clause violation through “approbation.”¹⁹³ For approbation to be proper, Congress, but not a department head, can delegate appointment authority, so long as the department head’s approval or consent is still required.¹⁹⁴ In the aftermath of *Hill*, scholars have cut both ways. Some have said that Congress does not need to take any legislative corrective actions as the Securities Exchange Act allows the SEC to “appoint and compensate officers.”¹⁹⁵ Therefore, “[T]he SEC can simply preclude the Chief ALJ’s selection from becoming effective without the Commissioners’ approval” and for current ALJs the SEC can appoint them to their already held positions but as inferior officers.¹⁹⁶ The Supreme Court has approved such a cure in the past.¹⁹⁷

Other commentary after the *Hill* case has stated that approbation by the SEC Commissioners would lack statutory authority because the APA does not expressly permit any person other than the agency to appoint ALJs.¹⁹⁸ Does this suggest the SEC’s lack of an argument regarding approbation suggests, as a factual matter, “the Commissioners never provided any consent or approval?”¹⁹⁹ Interestingly, in ALJ Grimes’ original denial of *Hill*’s motion to hear the constitutional issues, he explained that “Administrative Law Judges are creatures of statute” and goes into detail about how they are hired.²⁰⁰ He clarifies that “An agency wishing to appoint a new administrative law judge must request a

¹⁹³ Hardy et al, *The Appointment of SEC Administrative Law Judges: Constitutional Questions and Consequences for Enforcement Actions*, BLOOMBERG BNA SECURITIES REGULATION AND LAW REPORT (June 22, 2015) <http://perma.cc/6HHG-82HV>.

¹⁹⁴ *Id.*

¹⁹⁵ Walker, *supra* note 192.

¹⁹⁶ *Id.*

¹⁹⁷ See *Edmond v. United States*, 520 U.S. 651 (1997).

¹⁹⁸ Hardy et al, *supra* note 193. “Each agency shall appoint as many administrative law judges as are necessary for proceedings required to be conducted in accordance with sections 556 and 557” of the APA.40 Importantly, the APA does not expressly permit any person or entity, other than the ‘agency,’ to appoint ALJs. Thus, any approbation of SEC ALJs’ appointment would lack statutory authority and likely be insufficient to cure any constitutional defect in their appointment.”

¹⁹⁹ Hardy et al, *supra* note 193.

²⁰⁰ In the Matter of CHARLES L. HILL, JR., ORDER DENYING RESPONDENT’S MOTION FOR SUMMARY DISPOSITION ON CONSTITUTIONAL ISSUES. ADMINISTRATIVE PROCEEDING File No. 3-16383 at *2-3 (May 14, 2015) (available at <http://perma.cc/X34G-GZPV>).

list of eligible candidates from the Office of Personnel Management (OPM) and must choose from among the “highest three eligible” candidates certified by OPM.”²⁰¹ Could Congress’ use of the term “appoint” here, and the previous opinions allowing agencies to appoint “inferior agents” as a group, rather than as individuals, mean that the SEC system actually could work within the Appointments Clause? It has not been discussed by the courts.

Another question is what happens to the matters that have already been decided by the SEC administrative system, or are still pending administrative hearings, if a federal appellate court or the Supreme Court decide that the SECs administrative proceedings were presided over by unconstitutionally appointed ALJs? First, who, if any, could challenge their prior administrative proceedings in front of an unconstitutional ALJ? The principle of finality stands for the idea that when a judgment becomes final it typically cannot be attacked collaterally.²⁰² This principle is stronger than the mere showing that that the adjudicator was unconstitutional.²⁰³ It is therefore, very unlikely that those whose cases are final, especially those affirmed by the SEC Commissioners who were appointed by the Executive, could be attacked collaterally even if the SEC were found to have violated the Appointments Clause.²⁰⁴

What about parties whose administrative determinations are not yet final because they are still on direct review, or the period for seeking direct review has not yet expired? Some have speculated that a federal court holding that the appointments of the SEC’s ALJs are unconstitutional” should void their administrative adjudications altogether.²⁰⁵ What of the fact that the Commissioners review the ALJ’s initial orders de novo? The Supreme Court in *Ryder* held that even when a higher authority affirms a judge who was appointed in violation of the Constitution, the adjudication is still invalid.²⁰⁶ But it should be noted that the Court in *Ryder* overturned the conviction because the appeals court that affirmed the original conviction did not give the petitioner “all the possibility for relief” that review by a properly constituted appellate

²⁰¹ *Id.*

²⁰² *Teague v. Lane*, 489 U.S. 288, 309 (1989).

²⁰³ *Hardy et al*, *supra* note 193.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *See Ryder v. United States*, 515 U.S. 177 (1995).

review would have given him.²⁰⁷ In light of *Ryder*, those SEC administrative proceedings that are not yet final would likely be held invalid. So what options does the SEC have?

B. SEC Options

There are several options for the SEC. The SEC Commissioners have more power over review of ALJ matters than did the appellate court in *Ryder*, but the respondents in SEC actions are still owed a hearing and it is unlikely the SEC Commissioners would be willing to sit for a hearing for every yet-to-be adjudicated administrative proceeding.²⁰⁸ This is an improbable and untenable situation. Another option available to the Government is to argue, as in *Ryder*, that the “de facto” doctrine applies to the SEC ALJs, which would confer validity on the actions taken by the ALJs acting under the title “inferior officer” even though it is later discovered that their appointment was insufficient.²⁰⁹ But the court in *Ryder* was apprehensive about allowing the de facto doctrine to undermine the Appropriations Clause because it may lead to less incentive to raise Appointments Clause questions in respect to judicial appointments.²¹⁰

Another option, which the SEC seems unwilling to do, is appoint the ALJs in a manner consistent with Article II by using approbation.²¹¹ If the SEC were to do so, it would be tacitly accepting the theory that ALJs are “inferior officers,” rather than employees. This would mean potentially shifting the Government’s position after arguing the SEC

²⁰⁷ *Id.*

²⁰⁸ Also, the Supreme Court in somewhat similar circumstances has an Appointments Clause challenge should not consider the merits of the decision rendered by the unconstitutionally-appointed adjudicator. See *Nguyen v. United States*, 539 U.S. 69, 80-81, 123 S. Ct. 2130, 2137, 156 L. Ed. 2d 64 (2003).

²⁰⁹ *Ryder v. United States*, 515 U.S. 177, 177 (1995).

²¹⁰ Hardy et al, *supra* note 193. Citing *Ryder v. United States*, 515 U.S. 177, 182-183 (1995).

²¹¹ Russell-Kraft, *supra* note 1. “The SEC dodged the question [of how to cure a potential Appointment violation] in a letter Monday, writing instead that the agency has no plans to change the way it appoints its judges while it waits for the solicitor general to approve the appeal to the Eleventh Circuit. ‘This is particularly the case when the SEC has over 100 litigated proceedings at various stages of the administrative process and the ALJ scheme has been in use for seven decades and is grounded in a highly-regulated competitive service system that Congress created for the selection, hiring and appointment of ALJs in the executive branch,’ the agency told Judge Berman.”

ALJs are employees..²¹² As explained earlier, the SEC ALJ's responsibilities and power have greatly increased over time, so even if they were simply employees at one point, rather than "inferior officers," it is much more probable that, for the purposes of Article II, they would be seen as "inferior officers" today.

Potentially, it is not all bad news for the SEC. If the SEC reappoints (or more accurately, appoints for the first time) their ALJs under Article II, the cases that were vacated because of the unconstitutional appointments could be remanded to those same ALJs.²¹³ Besides extra work for the Government, those respondents who were hoping to avoid the ALJ system altogether actually risk the expense and potentially less desirable outcomes of having to go through a second administrative proceeding.²¹⁴

Some practitioners have taken an exasperated, if not threatening, tone saying they expect to see more challenges "if the SEC goes down this road, which is their prerogative. Given the public reaction, the issue is, are they going to retrench?"²¹⁵ It is a good question. The better question is do they have to?

VII. CONCLUSION

Since the advent of Dodd-Frank, which allowed the SEC to bring far more enforcement actions in its own administrative proceedings rather than federal court, many have challenged the constitutionality of the Agency's administrative proceedings. Both Judge Jed Rakoff and the SEC's Head of Enforcement, Andrew Ceresney, have weighed in publicly on both ends of what has become a heated debate. Most of these challenges in federal court seem to be a way for practitioners to attempt to avoid an administrative proceeding where the SEC wins far more often than it does in federal court, but are usually thrown out for lack of subject matter jurisdiction.

Courts seem to agree that the SEC was given the explicit ability to choose a forum by Congress and have used this ability within the

²¹² Daniel R. Walfish, *The Real Problem With SEC Administrative Proceedings, and How To Fix It*, FORBES (7/20/2015 AT 7:55 AM EST) <http://perma.cc/LP6N-7ZLX>.

²¹³ Hardy et al, *supra* note 193.

²¹⁴ *Id.*

²¹⁵ Bradford, *supra* note 60.

constraints of Constitutional law.²¹⁶ There have only been three cases since 2010 where federal courts have found they have jurisdiction to decide Constitutional challenges that an SEC administrative proceeding was unconstitutional; one was settled, one found for the SEC, but a June 2015 case, *Hill*, found that the SEC ALJs may have been put in place in violation of the Article II Appointments Clause.

This conclusion is predicated on finding that the SEC ALJs are “inferior officers” of the Executive rather than “employees” of the SEC. This is disputed, but if federal appellate courts were to agree with *Hill’s* reasoning, it is very likely that all current SEC administrative proceedings would be invalidated and the SEC would have to appoint their ALJs via Article II and retry all current cases. This may seem like all bad news for the Government, but in the end, not only were the Constitutional challenges to the SEC’s use of administrative forums unappealing to federal judges, those respondents who argue that the SEC has violated the Appointments Clause may end up having to appear before the same administrative judge’s all over again, with new expense, and a potentially worse outcome.

²¹⁶ For the most part. See *Gupta v. S.E.C.*, 796 F. Supp. 2d 503 (S.D.N.Y. 2011).