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## Opinion: SEC's Home-Turf Venue Gives Undue Advantage

Commission handles more matters as administrative proceedings, and businesses are in peril.

By Mark Mermelstein, Guy Singer and Kevin Askew, The National Law Journal

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The U.S. Securities and Exchange Commission has, in recent months, embarked on a well-publicized strategy of bringing a greater number of its enforcement proceedings in-house before its own administrative law judges instead of in federal district court. Although the SEC traditionally reserved its administrative forum for cases against regulated parties such as accountants, the cases now being brought in-house include insider trading, accounting fraud and other cases against unregulated companies and individuals.

Until very recently, the SEC would almost certainly have brought these cases in federal court. However, the SEC is now taking advantage of provisions of the Dodd-Frank Act, which gave it the power to seek monetary civil penalties in administrative proceedings similar to those available in court.

The results of this undertaking are starting to come in and it appears, perhaps unsurprisingly, that the SEC's Division of Enforcement wins more often in its home court than it does in federal court, and the punishment meted out in this administrative forum against those on the losing end is more severe than it may have been in federal court.

### PERMANENTLY BARRED

As Judge Jed Rakoff of the U.S. District Court in New York pointed out in a recent speech, the SEC won 100 percent of its administrative hearings in the fiscal year ended September 2014, but only 61 percent of its federal court trials during the same period. Similarly, in the last year alone, administrative law judges in at least two litigated administrative proceedings have permanently barred respondents from serving as directors or officers of public companies.

Although it is impossible to know what punishments these individuals would have received if tried in federal district court, lifetime bars have historically been less common.

There is no clear answer to why respondents are losing and losing bigger in the administrative forum than in federal court, but a few procedural differences may affect the results.

Cases in the administrative forum are decided not by a jury but by an administrative law judge employed by the SEC. The Federal Rules of Evidence do not apply, and depositions are allowed only in very limited circumstances. If a witness refuses to sit for a voluntary pretrial interview with the respondent, the respondent will have little ability to combat that witness' trial testimony.

Respondents in administrative proceedings are also forced to proceed to trial on an expedited schedule, typically within four to five months of the initiation of the proceedings, even for the most complex cases.

This schedule means that respondents have limited time to review and digest the contents of the investigative file compiled by the Division of Enforcement, which may comprise millions of documents. The Division of Enforcement, by contrast, will have already been investigating the case for many months, if not years.

In the face of these procedural constraints and seemingly long odds, within the last year several respondents in pending or threatened SEC administrative proceedings have filed lawsuits against the agency in federal district court, challenging the constitutionality of the administrative proceedings and asking the courts to enjoin the proceedings from moving forward. No federal court has yet ruled on the merits of the constitutional challenges.

In the first wave of constitutional challenges, several parties asserted that the SEC's choice to initiate administrative proceedings against them, rather than sue them in federal court, violated their constitutional rights to due process and equal protection.

## **LACK OF JURISDICTION**

The SEC has successfully beaten back many of these challenges, not on the merits of the constitutional claims but rather by arguing that the constitutional claims must be raised directly in the administrative proceedings themselves and that the district courts lack jurisdiction to hear them.

More recently, parties have filed several lawsuits alleging that the exercise of executive power by the SEC's administrative law judges runs afoul of Article II of the U.S. Constitution. Relying on the 2010 U.S. Supreme Court decision in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, plaintiffs in these cases argue that because the SEC's administrative law judges enjoy at least two levels of tenure protection, the President lacks sufficient ability to remove them from office.

The first decision in one of these Article II challenges was handed down on March 3, when U.S. District Judge Rudolph Randa in Wisconsin dismissed a case brought by Laurie Bebo, the former chief executive officer of Assisted Living Concepts Inc.

Although Randa found Bebo's constitutional claims to be "compelling and meritorious," he held that he lacked jurisdiction to hear them and that Bebo must bring her claims first before the SEC and then, if necessary, to a court of appeals.

Meanwhile, a decision in at least one other case is imminent: On Feb. 11, U.S. District Judge Richard Berman in New York held a hearing to consider a request by former Standard & Poor's executive Barbara Duka to enjoin the SEC's administrative case against her. Berman took the matter under advisement.

Careful thought should be given as to whether to bring a constitutional challenge in federal district court. The results of the challenges to date have been less than encouraging.

There can be no doubt that the stakes in these cases are going up. The SEC is winning more often and it is exacting greater punishment than ever before.

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