

Stephen F. Austin State University

**SFA ScholarWorks**

---

Faculty Publications

Business Communication and Legal Studies

---

Fall 2015

## SEC IN-HOUSE TRIBUNALS: A CALL FOR REFORM

Drew Thornley

*Stephen F Austin State University*, [thornleyam@sfasu.edu](mailto:thornleyam@sfasu.edu)

Justin Blount

*Stephen F Austin State University*, [blountjr@sfasu.edu](mailto:blountjr@sfasu.edu)

Follow this and additional works at: [https://scholarworks.sfasu.edu/businesscom\\_facultypubs](https://scholarworks.sfasu.edu/businesscom_facultypubs)



Part of the [Securities Law Commons](#)

[Tell us](#) how this article helped you.

---

### Recommended Citation

Drew Thornley & Justin Blount, SEC In-House Tribunals: A Call for Reform, 62 Vill. L. Rev. 261 (2017).

Available at: <https://digitalcommons.law.villanova.edu/vlr/vol62/iss1/7>

This Article is brought to you for free and open access by the Business Communication and Legal Studies at SFA ScholarWorks. It has been accepted for inclusion in Faculty Publications by an authorized administrator of SFA ScholarWorks. For more information, please contact [cdsscholarworks@sfasu.edu](mailto:cdsscholarworks@sfasu.edu).



5-13-2017

# SEC In-House Tribunals: A Call for Reform

Drew Thornley

Justin Blount

Follow this and additional works at: <http://digitalcommons.law.villanova.edu/vlr>



Part of the [Administrative Law Commons](#), and the [Securities Law Commons](#)

---

## Recommended Citation

Drew Thornley & Justin Blount, *SEC In-House Tribunals: A Call for Reform*, 62 Vill. L. Rev. 261 (2017).

Available at: <http://digitalcommons.law.villanova.edu/vlr/vol62/iss1/7>

This Article is brought to you for free and open access by Villanova University Charles Widger School of Law Digital Repository. It has been accepted for inclusion in Villanova Law Review by an authorized editor of Villanova University Charles Widger School of Law Digital Repository. For more information, please contact [Benjamin.Carlson@law.villanova.edu](mailto:Benjamin.Carlson@law.villanova.edu).

2017]

## SEC IN-HOUSE TRIBUNALS: A CALL FOR REFORM

DREW THORNLEY\* AND JUSTIN BLOUNT\*\*

## INTRODUCTION

**I**N the aftermath of the 1929 crash of the stock market and during the height of the Great Depression, the federal government took steps to strengthen U.S. securities laws.<sup>1</sup> To that end, via the Securities Exchange Act of 1934, the U.S. Congress (Congress) created the U.S. Securities and Exchange Commission (SEC), whose “mission [is] to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”<sup>2</sup> As “the primary overseer and regulator of the U.S. securities markets,” the SEC has the power to bring enforcement actions against parties it believes to be in violation of the nation’s securities laws.<sup>3</sup>

The SEC has pursued such enforcement actions via two media: federal courts and the SEC’s in-house administrative tribunals (tribunals).<sup>4</sup> Pursuant to expanded authority granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),<sup>5</sup> the SEC has in-

---

\* Assistant Professor of Legal Studies, Rusche College of Business at Stephen F. Austin State University, B.A., Economics, The University of Alabama; J.D., Harvard Law School.

\*\* Assistant Professor of Business Law, Rusche College of Business at Stephen F. Austin State University, B.B.A., Finance, Southwestern Oklahoma State University; J.D., Baylor Law School; M.B.A., The University of Texas at Austin.

1. See 15 U.S.C. §§ 78a–78u-2 (2012).

2. See U.S. SEC. & EXCH. COMM’N, *What We Do*, <http://www.sec.gov/about/whatwedo.shtml#create> [<https://perma.cc/AX72-RK3P>] (last visited Jan. 20, 2017).

3. See *id.* (“The SEC oversees the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds. Here the SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud. Crucial to the SEC’s effectiveness in each of these areas is its enforcement authority. Each year the SEC brings hundreds of civil enforcement actions against individuals and companies for violation of the securities laws.”).

4. See U.S. SEC. & EXCH. COMM’N, *Litigation Releases*, <https://www.sec.gov/litigation/litreleases.shtml> [<https://perma.cc/93CT-6X34>] (last visited Jan. 20, 2017) (listing enforcement actions brought by SEC in federal court); see also U.S. SEC. & EXCH. COMM’N, *Administrative Proceedings*, <https://www.sec.gov/litigation/admin.shtml> [<https://perma.cc/VT3V-V3PB>] (last visited Jan. 20, 2017) (listing administrative actions taken by SEC outside of federal court system, including administrative tribunals).

5. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P(a), 124 Stat. 1376, 1862 (2010) [hereinafter Dodd-Frank Act] (amending 15 U.S.C. § 77h–1 to allow SEC to seek monetary penalties in cease and desist actions filed in administrative proceedings).

creased its use of enforcement actions via tribunals where, of late, it has a higher success rate than in such actions brought in federal courts.<sup>6</sup>

Several recent lawsuits have challenged the SEC's use of its tribunals. Specifically, plaintiffs have asserted chiefly that (1) defendants are afforded fewer procedural legal protections in tribunals than in federal courts, in violation of the U.S. Constitution's guarantees of due process, (2) the Administrative Law Judges (ALJs) who preside over the tribunals' evidentiary hearings are biased toward the SEC, and (3) the method of appointing the ALJs who sit on the tribunals violates the U.S. Constitution's Appointments Clause, infringing on the doctrine of separation of powers, upon which our country was founded.<sup>7</sup> Coincident with this ongoing litigation, opposition to the tribunals is growing elsewhere, with public calls from businesses, Congress, and others for reform of the SEC's system of administrative enforcement.<sup>8</sup>

This Article aims to provide an in-depth look at the issues being raised with respect to SEC tribunals and provide recommendations for reform to rectify these problems. Part I explores the history of the doctrine of separation of governmental powers and examines the history of the U.S. judicial branch and the distinction between courts created per Article III of the U.S. Constitution (Article III courts) and courts created per Article I of the U.S. Constitution (non-Article III courts), including U.S. administrative tribunals and SEC tribunals, specifically. Part II discusses and analyzes the current opposition to the SEC's tribunals and argues that even if the legal claims being made are successful, the underlying problems will

---

6. See Gretchen Morgenson, *Crying Foul on Plans to Expand the S.E.C.'s In-House Court System*, N.Y. TIMES (June 26, 2015), <http://www.nytimes.com/2015/06/28/business/secs-in-house-justice-raises-questions.html> [https://perma.cc/EZS6-TQ66] ("So far this year, the S.E.C. has a better record in federal court . . . and over the longer term the S.E.C. wins more often in its home courts. From 2012 through June 25, 2015, it succeeded on average in 92.7 percent of matters heard by its internal judges, versus a 77 percent success rate in federal courts. Against individuals, its success rate over the period is 84.7 percent in cases heard administratively, 76 percent in district courts.").

7. See Rebecca L. Dandy, *SEC Administrative Proceedings Under Constitutional Scrutiny*, VEDDER PRICE (Aug. 2015), <http://www.vedderprice.com/sec-administrative-proceedings-under-constitutional-scrutiny/> [https://perma.cc/GB2D-V7PV] (discussing due process, equal protection, and appointments clause challenges being made to SEC administrative proceedings). Another constitutional challenge that has been brought against these SEC tribunals is the assertion that they violate the Seventh Amendment's right to a trial by jury. See *Hill v. SEC*, 114 F. Supp. 3d 1297, 1313–16 (N.D. Ga. 2015), *vacated and remanded*, 825 F.3d 1236 (11th Cir. 2016) (discussing plaintiff's Seventh Amendment claim but ruling that plaintiff would be unable to establish likelihood of success on merits given Supreme Court precedent holding that Congress can allow for adjudication of public rights claims in administrative hearings without juries). However, this challenge has not been made as commonly as the other challenges referenced, has largely been unsuccessful, and presents its own unique challenges that are outside the scope of this Article given the Supreme Court precedents in this area. See *id.* Thus, this Article will focus on the more commonly raised issues referenced.

8. See *infra* Part II.

remain. Part III provides recommendations for remedying these problems by structuring a system of Article III courts to replace the SEC's administrative tribunals.

### I. SEPARATION OF POWERS AND THE JUDICIAL BRANCH

Central to this Article is the belief that the SEC's current system of administrative enforcement violates our Founding Fathers' idea of separate branches of government, each with distinct functions and powers that should not be infringed upon by the other branches. It is, thus, important to understand the need for separation of governmental powers and the structure and function of the judicial branch that our Founding Fathers put in place when they formed our country.

#### A. *Separation of Powers*

Though the phrase is not found in the U.S. Constitution, "separation of powers" was an important principle in the formation of our nation and remains a fundamental aspect of our national and state governments.<sup>9</sup> Our Founding Fathers believed in separate branches of government, each with specific powers and built-in protections against certain encroachments between and among branches.<sup>10</sup>

The idea of separation of powers predates the forming of our nation, and our founders built our government on principles espoused by many who came before them. Indeed, prior to the writing and ratification of the Constitution, the concept of separation of powers was imbedded in the constitutions and charters of various American colonies, which listed specific branches of government and their respective powers.<sup>11</sup> Going back

9. *See* *Mistretta v. United States*, 488 U.S. 361, 371 (1989) (discussing non-delegation doctrine, which prevents delegation of legislative power to another branch, and noting that it is "rooted in the principle of separation of powers that underlies our tripartite system of Government").

10. *See id.* at 380 ("This Court consistently has given voice to, and has reaffirmed, the central judgment of the Framers of the Constitution that, within our political scheme, the separation of governmental powers into three coordinate Branches is essential to the preservation of liberty." (citing *Morrison v. Olson*, 487 U.S. 654, 685–96 (1988); *Bowsher v. Synar*, 478 U.S. 714, 725 (1986))).

11. *See, e.g.*, GA. CONST. art. I (1777) ("The legislative, executive, and judiciary departments shall be separate and distinct, so that neither exercise the powers properly belonging to the other."); MD. CONST. art. VI (1776) ("That the legislative, executive and judicial powers of government, ought to be forever separate and distinct from each other."); MASS. CONST. pt. I, art. XXX (1780) ("In the government of this commonwealth, the legislative department shall never exercise the executive and judicial powers, or either of them; the executive shall never exercise the legislative and judicial powers, or either of them; the judicial shall never exercise the legislative and executive powers, or either of them; to the end it may be a government of laws and not of men."); N.J. CONST. art. XX (1776) ("That the legislative department of this government may, as much as possible, be preserved from all suspicion of corruption, none of the Judges of the Supreme or other Courts, Sheriffs, or any other person or persons possessed of any post of profit under the government, other than Justices of the Peace, shall be entitled to a seat

further, prior to the days of the American colonies, the idea of separation of powers was present in the writings of several influential philosophers and commentators, such as John Locke and Montesquieu, and their views, as well as the views of others, informed the thoughts of those who drafted the Constitution.

Though he focused on two functions of government—legislative and executive—John Locke espoused the position that those who create laws should not be those who execute them.<sup>12</sup> Montesquieu, in *De l'esprit des loix* (*The Spirit of the Laws*), discussed at length the importance of separate, distinct functions of government and the restraints placed on each by the others, drawing references to such balance of governmental powers present in the Roman Empire and the imbalance of powers in certain other governments.<sup>13</sup> He noted that every government consists of three basic powers: the legislative, executive, and judicial.<sup>14</sup> Montesquieu stressed that it is critical to liberty for these powers to be separated into distinct bodies of the government.<sup>15</sup> This need for separation of powers extends to the judicial power, and Montesquieu stressed the crucial importance of an independent judiciary.<sup>16</sup> These and other views helped shape the tri-

---

in the Assembly . . . .”); N.C. CONST. art. IV (1776) (“That the legislative, executive, and supreme judicial powers of government, ought to be forever separate and distinct from each other.”); PA. CONST. § 47 (1776) (“In order that the freedom of the commonwealth may be preserved inviolate forever, there shall be chosen by ballot by the freemen in each city and county respectively . . . two persons in each city and county of this state, to be called the Council of Censors . . . whose duty it shall be to enquire whether the constitution has been preserved inviolate in every part. . . .”); VA. CONST. (1776) (“The legislative, executive, and judiciary department, shall be separate and distinct, so that neither exercise the powers properly belonging to the other: nor shall any person exercise the powers of more than one of them, at the same time . . . .”).

12. See JOHN LOCKE, TWO TREATISES OF GOVERNMENT §§ 143, 144, 150, 159 (Peter Laslett ed., New Am. Library 1965) (1689) (“And because it may be too great a temptation to humane frailty apt to grasp at Power, for the same Persons who have the Power of making Laws, to have also in their hands the power to execute them, whereby they may exempt themselves from Obedience to the Laws they make, and suit the Law, both in its making and execution, to their own private advantage, and thereby come to have a distinct interest from the rest of the Community, contrary to the end of Society and Government . . . .”).

13. See CHARLES DE SECONDAT & BARON DE MONTESQUIEU, DE L'ESPRIT DES LOIX 73 (Thomas Nugent trans., Batoche Books 2001) (1748) (discussing Roman philosopher Cicero).

14. See *id.* at 173 (“In every government there are three sorts of power: the legislative; the executive in respect to things dependent on the law of nations; and the executive in regard to matters that depend on the civil law . . . . The latter we shall call the judiciary power, and the other simply the executive power of the state.”).

15. See *id.* (“When the legislative and executive powers are united in the same person, or in the same body of magistrates, there can be no liberty; because apprehensions may arise, lest the same monarch or senate should enact tyrannical laws, to execute them in a tyrannical manner.”).

16. See *id.* (“Again, there is no liberty, if the judiciary power be not separated from the legislative and executive. Were it joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control; for the judge would be

partite system of government that our Founding Fathers created and that remains today.

The Supreme Court of the United States has also stressed the vital importance of separation of powers and, specifically, an independent judiciary, writing in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*<sup>17</sup> that “our Constitution unambiguously enunciates a fundamental principle—that the ‘judicial Power of the United States’ must be reposed in an independent Judiciary. It commands that the independence of the Judiciary be jealously guarded, and it provides clear institutional protections for that independence.”<sup>18</sup> Similar to Montesquieu, the Supreme Court has made other strong statements about the necessity of separation of powers and an independent judiciary to a properly functioning government.<sup>19</sup> These time-honored principles of good governance are as important and as true today as they were at the time they were written.

#### B. *The U.S. Judicial Branch: Article III Courts and Judicial Power*

Clearly, the doctrine of separation of powers has a rich tradition in both European and American political thought and governance, and a fundamental aspect of separation of powers is the independence of the judiciary.<sup>20</sup> Our Founding Fathers recognized this principle and created an independent judicial branch via Article III of the Constitution.<sup>21</sup>

Section I of Article III establishes that the power to carry out the judicial role rests with the judicial branch: “The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.”<sup>22</sup> Thus, the Constitution allowed for the creation of one supreme-in-power court—the

---

then the legislator. Were it joined to the executive power, the judge might behave with violence and oppression.”).

17. 458 U.S. 50 (1982).

18. *Id.* at 60.

19. *See e.g., id.* at 57 (“Basic to the constitutional structure established by the Framers was their recognition that ‘[t]he accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny.’ To ensure against such tyranny, the Framers provided that the Federal Government would consist of three distinct Branches . . . .” (alteration in original) (citation omitted)); *United States v. Will*, 449 U.S. 200, 217–18 (1980) (“A Judiciary free from control by the Executive and Legislature is essential if there is a right to have claims decided by judges who are free from potential domination by other branches of government.”); *Buckley v. Valeo*, 424 U.S. 1, 122 (1976) (“The Framers regarded the checks and balances that they had built into the tripartite Federal Government as a self-executing safeguard against the encroachment or aggrandizement of one branch at the expense of the other.”), *superseded by statute as stated in* *McCConnell v. Fed. Election Comm’n*, 540 U.S. 93 (2003), *overruled by* *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310 (2010).

20. *See supra* Part I.A.

21. *See* U.S. CONST. art. III (establishing judicial branch of U.S. government).

22. *See id.* § 1.

Supreme Court<sup>23</sup>—and empowered Congress to create lower courts as it saw fit.<sup>24</sup> These courts collectively constitute the federal judiciary and are referred to here as Article III courts. Any courts or tribunals established outside of Congress’s Article III authority, including the SEC’s in-house tribunals that are the subject of this Article, are referred to here as non-Article III courts.<sup>25</sup>

The federal courts currently established pursuant to Article III are as follows: the Supreme Court,<sup>26</sup> U.S. Courts of Appeals,<sup>27</sup> U.S. District Courts,<sup>28</sup> and the U.S. Court of International Trade.<sup>29</sup> Defining characteristics of Article III courts are that their judges and justices (1) are appointed in compliance with the Appointments Clause<sup>30</sup> and (2) enjoy tenure and salary protection, which means they can hold their position for life, barring impeachment, and their salary will not be reduced while in

23. *See id.*; *see also* Judiciary Act of 1789, ch. 20, § 1, 1 Stat. 73, 73 (creating Supreme Court pursuant to constitutional authority).

24. *See* U.S. CONST. art. III, § 1; *see also* Judiciary Act of 1789, §§ 2–3, 1 Stat. at 73–74 (dividing country into district courts and judges).

25. These courts or tribunals could also be referred to as “Article I courts,” “Article I tribunals,” “legislative courts,” “legislative tribunals,” or “non-Article III tribunals.”

26. *See* 28 U.S.C. §§ 1–6 (2012) (outlining organization and structure of Supreme Court). The Supreme Court currently “consist[s] of a Chief Justice” and “eight associate justices, any six of whom shall constitute a quorum.” *Id.* § 1; *see also* SUP. CT. OF U.S., *The Court as an Institution*, <http://www.supremecourt.gov/about/institution.aspx> [<https://perma.cc/TK8L-U7FE>] (last visited Jan. 20, 2017) (discussing creation and history of Supreme Court).

27. *See* 28 U.S.C. §§ 43–44 (2012) (establishing Circuit Courts of Appeal and providing for judges’ service and tenure in accordance with Article III); *see also* FED. JUD. CTR., *The U.S. Courts of Appeals and the Federal Judiciary*, [http://www.fjc.gov/history/home.nsf/page/courts\\_of\\_appeals.html](http://www.fjc.gov/history/home.nsf/page/courts_of_appeals.html) [<https://perma.cc/MTB9-5ZDJ>] (last visited Jan. 20, 2017).

28. *See* 28 U.S.C. §§ 132–135 (2012) (establishing district courts and providing for judges’ service and tenure in accordance with Article III); *see also* FED. JUD. CTR., *The U.S. District Courts and the Federal Judiciary*, [http://www.fjc.gov/history/home.nsf/page/courts\\_district.html](http://www.fjc.gov/history/home.nsf/page/courts_district.html) [<https://perma.cc/2M5U-FXPC>] (last visited Jan. 20, 2017).

29. *See* 28 U.S.C. §§ 251–252 (2012) (establishing Court of International Trade and providing for judges’ service and tenure in accordance with Article III); *see also* FED. JUD. CTR., *The U.S. Court of International Trade, 1980–*, [http://www.fjc.gov/history/home.nsf/page/courts\\_special\\_cit.html](http://www.fjc.gov/history/home.nsf/page/courts_special_cit.html) [<https://perma.cc/P98Y-NFTG>] (last visited Jan. 20, 2017).

30. *See* U.S. CONST. art. II, § 2 (noting President “shall have power, by and with the Advice and Consent of the Senate, to . . . appoint Ambassadors, other public Ministers and Consuls, judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments”).



office.<sup>31</sup> These salary and tenure protections are intended to ensure the independence of the judiciary.<sup>32</sup>

That the judicial branch has been vested with judicial power is not to say the other branches of government have no role in the federal judiciary. For example, Article II, Section 2, of the Constitution gives the President the power to nominate Supreme Court justices, “with the Advice and Consent of the Senate.”<sup>33</sup> Additionally, Congress possesses such powers as the ability to alter the number of Supreme Court justices and to create different types of jurisdiction for the various courts, each of which it has done.<sup>34</sup> Although Congress has certain powers affecting the judicial branch, the Constitution vests judicial power itself solely with the judicial branch—the Supreme Court and the inferior courts created under Article III, as these are the only courts that possess the essential characteristics of Article III judges and justices.<sup>35</sup>

This begs the question, what is judicial power, exactly? In *Muskrat v. United States*,<sup>36</sup> Justice Miller spoke of this power as “the right to determine actual controversies arising between adverse litigants, duly instituted in courts of proper jurisdiction.”<sup>37</sup> In *Plaut v. Spendthrift Farm, Inc.*,<sup>38</sup> Justice Scalia wrote, “Article III establishes a ‘judicial department’ with the ‘province and duty . . . to say what the law is’ in particular cases and controversies.”<sup>39</sup> Thus, the Supreme Court has made clear that the judicial power is

---

31. *See id.* art. III, § 1 (“The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.”).

32. *See* *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 59 (1982) (“Both of these provisions were incorporated into the Constitution to ensure the independence of the Judiciary from the control of the Executive and Legislative Branches of government.”).

33. *See* U.S. CONST. art. II, § 2.

34. *See* FED. JUD. CTR., *Landmark Judicial Legislation: The Judiciary Act of 1869*, [http://www.fjc.gov/history/home.nsf/page/landmark\\_10.html](http://www.fjc.gov/history/home.nsf/page/landmark_10.html) [https://perma.cc/N5G9-AE3X] (last visited Jan. 20, 2017) (noting that Supreme Court was first established with six justices and Congress has both decreased and increased number of justices since Court was created); *see also* FED. JUD. CTR., *Landmark Judicial Legislation: The Jurisdiction and Removal Act of 1875*, [http://www.fjc.gov/history/home.nsf/page/landmark\\_11.html](http://www.fjc.gov/history/home.nsf/page/landmark_11.html) [https://perma.cc/LC9J-NYTD] (last visited Jan. 20, 2017) (discussing various acts throughout history where Congress broadened or narrowed federal court jurisdiction).

35. *See N. Pipeline Constr. Co.*, 458 U.S. at 58 (“As an inseparable element of the constitutional system of checks and balances, and as a guarantee of judicial impartiality, Art. III both defines the power and protects the independence of the Judicial Branch . . . . The inexorable command of this provision is clear and definite. The judicial power of the United States must be exercised by courts having the attributes prescribed in Art. III.”).

36. 219 U.S. 346 (1911).

37. *See Muskrat v. United States*, 219 U.S. 346, 361 (1911).

38. 514 U.S. 211 (1995).

39. *See Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 218 (1995) (quoting *Marbury v. Madison*, 1 Cranch 137, 177 (1803)). Justice Miller went on to state:

the power to *decide* in a binding manner, with conclusive judgments, actual cases and controversies that appear before the courts and are properly within the courts' jurisdiction.<sup>40</sup>

What cases and controversies, then, are within Article III's jurisdiction? Article III conveniently lists specific areas of federal jurisdiction.<sup>41</sup> In addition to establishing that the judicial power extends to all cases arising under the Constitution, Section 2 states that such power extends to all cases "arising under . . . the Laws of the United States."<sup>42</sup> Federal securities laws are certainly among such cases, as all federal statutes are clearly "Laws of the United States." Thus, if Article III is read literally, if the federal government chooses to allow for the use of federal judicial power over any case and controversy alleging a violation of a federal securities law, that case would seem to belong exclusively in the hands of the judicial branch.<sup>43</sup>

But Article III has not been interpreted so literally, and in the United States, cases and controversies are frequently heard outside of the Article III judiciary, a practice widely upheld as constitutional by the Supreme Court.<sup>44</sup> Thus, while it is clear that Article III courts have judicial power to

---

The record of history shows that the Framers crafted this charter of the judicial department with an expressed understanding that it gives the Federal Judiciary the power, not merely to rule on cases, but to *decide* them, subject to review only by superior courts in the Article III hierarchy—with an understanding, in short, that "a judgment conclusively resolves the case" because "a 'judicial Power' is one to render dispositive judgments."

*Id.* at 218–19 (quoting Frank H. Easterbrook, *Presidential Review*, 40 CASE W. RES. L. REV. 905, 926 (1990)).

40. *See id.* at 218–19.

41. *See* U.S. CONST. art. III, § 2. Specifically, Article II states:

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;— between a State and Citizens of another State,—between Citizens of different States,—between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

*Id.*

42. *See id.*

43. *See* Erwin Chemerinsky, *Formalism Without a Foundation: Stern v. Marshall*, 2011 SUP. CT. REV. 183, 190–91 (noting literal reading of Article III leads to conclusion that all inferior courts exercising judicial power must have judges that comport with Article III requirements of life tenure and salary protection).

44. *See id.* ("But it never has been that way."); James E. Pfander, *Article I Tribunals, Article III Courts, and the Judicial Power of the United States*, 118 HARV. L. REV. 643, 646 (2004) ("Nearly everyone agrees that Article III defies literal application . . . . [D]espite the importance of these provisions to the framing of the Constitution and their centrality to founding-era notions of judicial independence and the separation of powers, Congress has often assigned disputes that appear to

render judgments in disputes involving federal securities laws, the question that must be addressed is whether and when non-Article III courts or tribunals can also be constitutionally granted such power by Congress or otherwise.

C. *The Creation, Constitutionality, and Power of Non-Article III Courts*

Article I, Section 8, of the Constitution gives Congress the power “[t]o constitute Tribunals inferior to the Supreme Court.”<sup>45</sup> It is worth noting the literal distinction between this section’s use of the term “Tribunals” and Article III’s use of the phrase “inferior Courts.”<sup>46</sup> Article III establishes Congress’s power to create lower courts in the federal judiciary, while Article I empowers Congress to create tribunals outside of the federal judiciary.<sup>47</sup> Congress’s authority to create such non-Article III courts has been upheld by the Supreme Court.<sup>48</sup> Thus, Congress can create non-Article III courts that possess certain judicial power.<sup>49</sup> The Supreme Court has placed limits on the use of such courts, but determining the exact scope of these limits is difficult, if not impossible.<sup>50</sup>

Delivering the Supreme Court’s plurality opinion in *Northern Pipeline*, Justice Brennan held that Congress’s authority to create non-Article III courts is quite limited.<sup>51</sup> The Court identified only three “historically rec-

---

fall within the scope of the federal judicial power to Article I tribunals whose judges lack salary and tenure protections.”).

45. See U.S. CONST. art. I, § 8.

46. See Pfander, *supra* note 44, at 650 (noting textual distinction in provisions and potential importance to constitutional interpretation).

47. See *Ex parte Bakelite Corp.*, 279 U.S. 438, 449 (1929) (“While article 3 of the Constitution declares, in section 1, that the judicial power of the United States shall be vested in one Supreme Court and in ‘such inferior courts as the Congress may from time to time ordain and establish,’ and prescribes, in section 2, that this power shall extend to cases and controversies of certain enumerated classes, it long has been settled that article 3 does not express the full authority of Congress to create courts . . .”).

48. See, e.g., *Williams v. United States*, 289 U.S. 553, 555–56 (1933) (“That judicial power apart from that article may be conferred by Congress upon legislative courts, as well as upon constitutional courts, is plainly apparent . . . . [T]he appellate jurisdiction of this court over judgments and decrees of the legislative courts has been upheld and freely exercised under acts of Congress from a very early period . . . .” (citation omitted)).

49. See *id.*

50. See *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 583 (1985) (“An absolute construction of Article III is not possible in this area of ‘frequently arcane distinctions and confusing precedents.’” (quoting *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 90 (1982) (Rehnquist & O’Connor, JJ., concurring))).

51. See *N. Pipeline Constr. Co.*, 458 U.S. at 70 (“In sum, this Court has identified three situations in which Art. III does not bar the creation of legislative courts. In each of these situations, the Court has recognized certain exceptional powers bestowed upon Congress by the Constitution or by historical consensus. Only in the face of such an exceptional grant of power has the Court declined to hold the authority of Congress subject to the general prescriptions of Art. III.”).

ognized situations” in which non-Article III courts could be created by Congress and fall outside of Article III: “non-Art[icle] III courts of the Territories or of the District of Columbia, courts-martial, and resolution of ‘public rights’ issues.”<sup>52</sup> The Court declined to define what a “public right” was “definitively” but ruled that, “at a minimum,” a public rights issue must involve cases “between the government and others,” as opposed to two private citizens.<sup>53</sup> Such limits proved to be short-lived, and since *Northern Pipeline*, the Supreme Court has expanded the reach of non-Article III courts into areas beyond the three listed in *Northern Pipeline*.<sup>54</sup>

Even prior to *Northern Pipeline*, our country has had a long history of administering judicial functions through non-Article III courts in myriad situations.<sup>55</sup> A number of scholars have challenged the validity of such tribunals on grounds that they violate a literal reading of Article III.<sup>56</sup> Even among those who believe Article I tribunals violate a literal interpretation of Article III, it is widely accepted that such tribunals are so firmly settled as part of our system of jurisprudence that undoing them now would be unfeasible.<sup>57</sup> That said, it cannot be denied that the nation’s

52. *See id.* at 51 (discussing three historical situations as only situations “in which the principle of independent adjudication commanded by Art. III does not apply”).

53. *See id.* at 69 (“The distinction between public rights and private rights has not been definitively explained in our precedents . . . [A] matter of public rights must at a minimum arise ‘between the government and others.’” (quoting *Ex parte Bakelite Corp.*, 279 U.S. 438, 451 (1929))).

54. *See, e.g.*, *Commodity Futures Trading Comm’n v. Schor*, 478 U.S. 833, 849 (1986) (allowing reparations complaint and subsequent common law counterclaim between private parties to proceed in front of non-Article III ALJ because complaining party waived Article III rights); Pfander, *supra* note 44, at 647–48 (“After an ill-fated and relatively short-lived attempt to establish categorical limits to non-Article III adjudication in the *Northern Pipeline* [sic] case, the Court has seemingly retreated to a multifaceted balancing test that includes judicial independence as one factor and often results in validation of Article I tribunals.”).

55. *See* Pfander, *supra* note 44, at 656–67 (“Ever since the earliest days of the Republic, Congress has staffed Article I tribunals with non-Article III judges and has charged them with resolving matters that most observers regarded as coming within the scope of the judicial power of the United States . . .”).

56. *See* Steven G. Calabresi & Kevin H. Rhodes, *The Structural Constitution: Unitary Executive, Plural Judiciary*, 105 HARV. L. REV. 1153, 1189 (1992) (“Professor Redish concludes from the language of the Article III Vesting Clause that legislative courts are illegitimate to the extent that they exercise judicial power of the United States . . . . The words of the Article III Vesting Clause permit no other conclusion.” (footnote omitted)); Gary Lawson, *Territorial Governments and the Limits of Formalism*, 78 CALIF. L. REV. 853, 908 (1990) (noting that formalist reading of Constitution renders Article I territorial courts unconstitutional because “[a]ll judicial proceedings in the territories, whether involving national or local law, must take place before tribunals whose judges satisfy the tenure and salary provisions of [A]rticle III”); Pfander, *supra* note 42, at 660 (“Scholars have largely . . . suggest[ed] that our institutional history essentially forecloses a literal reading of the text . . .”).

57. *See e.g.*, Pfander, *supra* note 44, at 775 (“A return to literalism, though supported by a few hardy formalists, has seemed unthinkable to those who recognize and accept the vast scope of the administrative state.”).

current system of non-Article III courts, including the administrative tribunals utilized by the SEC, does not strictly adhere to the words of Article III.<sup>58</sup> Nevertheless, given the widespread use and acceptance of administrative tribunals, it is highly doubtful that any challenge to the SEC's ALJs on Article III grounds would be successful.<sup>59</sup> Given that the Supreme Court has upheld the constitutionality of non-Article III courts, those challenging their validity have found it necessary to look to other legal theories. In order to better understand these legal challenges, this Article next provides an explanation of the modern U.S. administrative law tribunals system, generally, and SEC administrative law tribunals, specifically.

#### D. *The United States Administrative Law Tribunal System*

The modern structure of the administrative tribunal and ALJ system dates to June 11, 1946, when Congress enacted the Administrative Procedure Act (APA).<sup>60</sup> The APA authorized administrative agencies' use of "examiners" to preside over agencies' adjudicative hearings.<sup>61</sup> The 1946 APA was repealed as part of the general revision of the U.S. Code, and in the current version of the APA, these examiners are referred to as ALJs.<sup>62</sup> Agency hearings may now be presided over by "(1) the agency; (2) one or more members of the body which comprises the agency; or (3) one or more administrative law judges appointed under section 3105 of this title."<sup>63</sup>

These administrative tribunals adjudicate parties' rights within their respective agency's purview and operate very much like court proceedings. Among other powers, the presiding party may make factual findings, take depositions, and issue subpoenas.<sup>64</sup> ALJs have broad statutory authority to

58. See Gordon G. Young, *Public Rights and the Federal Judicial Power: From Murray's Lessee through Crowell to Schor*, 35 *BUFF. L. REV.* 765, 768–69 (1987) (noting that Supreme Court has clearly not interpreted Article III literally and has allowed for adjudication of disputes to occur in non-Article III courts).

59. See, e.g., *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 77 (1982) (noting administrative agencies utilizing adjudicative power as "adjuncts" of courts has been upheld as constitutional); *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 450, n.7 (1977) ("In cases which do involve only 'private rights,' this Court has accepted factfinding by an administrative agency, without intervention by a jury, only as an adjunct to an Art. III court . . .").

60. See Pub. L. No. 79-404, 60 Stat. 237.

61. See *id.* § 11, 60 Stat. at 244 ("Subject to the civil-service and other laws to the extent not inconsistent with this Act, there shall be appointed by and for each agency as many qualified and competent examiners as may be necessary for proceedings . . .").

62. See 5 U.S.C. § 556 (b)(3) (2012) (noting that administrative hearings may be presided over by "one or more administrative law judges appointed under section 3105 of this title"); 5 U.S.C. § 3105 (2012) ("Each agency shall appoint as many administrative law judges as are necessary for proceedings . . .").

63. See 5 U.S.C. § 556(b).

64. See *id.* § 556(c) (listing activities in which "employees presiding at hearings" may take part).

preside over and rule on cases brought before them, and those decisions usually “become[] the decision[s]” of the ALJs’ respective agencies.<sup>65</sup> While there is a right to appeal these agency decisions to an Article III court, the standard of review is quite deferential to the agency.<sup>66</sup>

ALJs are employees of their respective agencies, but their hiring is coordinated by the U.S. Office of Personnel Management (OPM).<sup>67</sup> Created by a 1978 act of Congress, OPM “is an independent establishment in the executive branch.”<sup>68</sup> In an effort to ensure the hiring of qualified ALJs, OPM has instituted several qualification requirements in the areas of licensing, qualification, and examination, as well as conditions for continued employment.<sup>69</sup> Also, OPM, as overseer of the General Schedule classification and pay system that covers the majority of federal civilian employees, determines and manages the pay of ALJs.<sup>70</sup> As with other federal employees, ALJs’ pay is not protected against salary diminishment.<sup>71</sup> In contrast to Article III judges, then, ALJs are hired, rather than appointed by the President and confirmed by the Senate, and lack lifetime tenure protection.

#### E. SEC Administrative Tribunals

With an understanding of administrative tribunals, generally, this Article turns specifically to SEC ALJs. Currently, the SEC employs five ALJs.<sup>72</sup> These ALJs are housed in the Office of Administrative Law Judges,

65. See 5 U.S.C. § 557(b) (2012) (“When the agency did not preside at the reception of the evidence, the presiding employee . . . shall initially decide the case unless the agency requires, either in specific cases or by general rule, the entire record to be certified to it for decision. When the presiding employee makes an initial decision, that decision then becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule.”).

66. See *infra* notes 126–29 and accompanying text.

67. See OFF. PERSONNEL MGMT., *Administrative Law Judges*, <https://www.opm.gov/services-for-agencies/administrative-law-judges/> [<https://perma.cc/HWP7-PHQV>] (last visited Jan. 20, 2017) (noting agency is responsible for “planning, operating and directing the recruitment, examination and employment of ALJs”).

68. See Civil Service Reform Act of 1978, Pub. L. No. 95-454, § 201, 92 Stat. 1111, 1118–21 (codified at 5 U.S.C. §§ 1101–1105 (2012)).

69. See OFF. PERSONNEL MGMT., *Qualification Standard for Administrative Law Judge Positions*, <https://www.opm.gov/policy-data-oversight/classification-qualifications/general-schedule-qualification-standards/specialty-areas/administrative-law-judge-positions/> [<https://perma.cc/QRG8-GWX4>] (last visited Jan. 20, 2017).

70. See OFF. PERSONNEL MGMT., *Pay & Leave*, <https://www.opm.gov/policy-data-oversight/pay-leave/salaries-wages/2015/executive-senior-level> [<https://perma.cc/4T5F-GTNW>] (last visited Jan. 20, 2017) (providing 2015 employee pay tables for ALJs).

71. See 5 C.F.R. § 536.308 (2016) (setting forth rules regarding administrative employee pay retention and providing examples of when pay can be changed).

72. See, e.g., Letter from Gibson, Dunn & Crutcher to Clients & Friends 2 (Jan. 12, 2015), <http://www.gibsondunn.com/publications/documents/2014-Year-End-Securities-Enforcement-Update.pdf> [<https://perma.cc/D3BS-2QXG>] (noting

an office within the Division of Enforcement.<sup>73</sup> The SEC's Division of Enforcement pursues legal action against alleged violators of federal securities laws in two venues: (1) lawsuits in federal courts, or (2) in-house administrative hearings conducted by its staff of ALJs.<sup>74</sup> The SEC considers this function to be very important, as, in its own words,

[f]irst and foremost, the SEC is a law enforcement agency. The Enforcement Division assists the Commission in executing its law enforcement function by recommending the commencement of investigations of securities law violations, by recommending that the Commission bring civil actions in federal court or before an administrative law judge, and by prosecuting these cases on behalf of the Commission.<sup>75</sup>

If the SEC pursues administrative enforcement, which it does by issuing an Order Instituting Proceedings, the hearing is presided over by one of the SEC's five ALJs, and the SEC describes the ALJs as "independent adjudicators."<sup>76</sup> In these hearings, these ALJs act very much like judges in federal court and possess many of the same judicial powers.<sup>77</sup> Upon hearing the evidence presented by the parties in the hearing, the ALJ has the authority to issue findings of fact, legal conclusions, and even order sanctions.<sup>78</sup> Further, ALJs have great discretion regarding the scope of these hearings and may even dispose of cases summarily without a live eviden-

---

number of ALJs increased from three to five in 2014 to handle "increased administrative caseload").

73. See SEC. & EXCH. COMM'N, *Office of Administrative Law Judges*, <http://www.sec.gov/alj> [<https://perma.cc/KP9Q-V4WP>] (last visited Jan. 20, 2017) (discussing SEC's Office of ALJs).

74. See *What We Do*, *supra* note 2 ("Whether the Commission decides to bring a case in federal court or within the SEC before an administrative law judge may depend upon the type of sanction or relief that is being sought. For example, the Commission may bar someone from the brokerage industry in an administrative proceeding, but an order barring someone from acting as a corporate officer or director must be obtained in federal court. Often, when the misconduct warrants it, the Commission will bring both proceedings.").

75. SEC. & EXCH. COMM'N, *How Investigations Work*, <https://www.sec.gov/News/Article/Detail/Article/1356125787012> [<https://perma.cc/VZ3B-9SCB>] (last visited Jan. 20, 2017).

76. See *Office of Administrative Law Judges*, *supra* note 73 ("Administrative law judges serve as independent adjudicators.").

77. See *id.* ("Under the Administrative Procedure Act and the Commission's Rules of Practice, administrative law judges conduct public hearings . . . in a manner similar to non-jury trials in the federal district courts . . . [T]hey issue subpoenas, hold prehearing conferences, and rule on motions and the admissibility of evidence.").

78. See *id.* (noting that SEC ALJs have power to order sanctions including "cease-and-desist orders; investment company and officer-and-director bars; censures, suspensions, [and] limitations on activities").

tiary hearing.<sup>79</sup> In either case, “[a]n initial decision becomes final when the Commission enters a finality order.”<sup>80</sup>

While this process grants significant authority to ALJs, either the SEC or the defendant may appeal the ALJ’s decision to the Commission, which conducts a *de novo* review.<sup>81</sup> The Commission also has discretion to review a decision “on its own initiative,” without appeal of the parties.<sup>82</sup> Within sixty days of the date of the ruling, the parties have a further right of appeal to an appropriate U.S. Court of Appeals—either the U.S. Court of Appeals for the District of Columbia, the appeals court in the circuit where the appellant resides, or the appeals court in the circuit where the appellant’s principal place of business is located.<sup>83</sup>

## II. OPPOSITION TO SEC TRIBUNALS

While the SEC’s administrative tribunal system has existed for quite some time, opposition to the SEC’s use of these tribunals has recently gained significant traction.<sup>84</sup> This recent spike in opposition resulted chiefly from the SEC’s decision to bring more cases before their tribunals, instead of federal courts, in response to new powers granted to them by Dodd-Frank.<sup>85</sup>

Before Dodd-Frank, the SEC could seek civil monetary penalties in administrative hearings against only “registered” parties for alleged viola-

79. See *id.* (noting possibility of “summary disposition” with respect to “certain proceedings”).

80. *Id.*

81. See *id.* (noting that Commission “performs a *de novo* review [of initial decisions] and can affirm, reverse, modify, set aside, or remand for further proceedings”).

82. See *id.*

83. See *id.*; 15 U.S.C. § 78y(a)(1) (2012) (“A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.”).

84. See, e.g., Morgenson, *supra* note 6 (“Given that administrative law judges are employees of the S.E.C., defendants wonder if they can be fair.”).

85. See Robert Anello, *Addressing the SEC’s Administrative “Home Court” Advantage in Enforcement Proceedings*, FORBES (Sept. 7, 2015, 4:40 PM), <http://www.forbes.com/sites/insider/2015/09/07/addressing-the-secs-administrative-home-court-advantage-in-enforcement-proceedings/#4226cc6454ea> [https://perma.cc/UYH9-CS4U] (“In 2010, the Dodd-Frank Act provided the SEC with the option of pursuing administrative proceedings in lieu of filing an action in federal court in cases in which it sought monetary penalties. The agency embraced this option whole-heartedly.”); Jed S. Rakoff, U.S. Dist. Judge for the S. Dist. of N.Y., *Is the S.E.C. Becoming a Law unto Itself?*, Keynote Address at the PLI Securities Regulation Institute 5 (Nov. 5, 2014), <https://securitiesdiary.files.wordpress.com/2014/11/rakoff-qli-speech.pdf> [https://perma.cc/LQU8-TSRP] (discussing expansion of administrative powers granted to SEC post Dodd-Frank and how SEC has used expanded powers by bringing more administrative proceedings).



tions of the Securities Exchange Act of 1934.<sup>86</sup> For unregistered parties violating the Securities Act of 1933, the SEC could pursue monetary penalties only in federal courts because the SEC administrative courts had authority only to issue cease-and-desist orders.<sup>87</sup> However, Dodd-Frank granted the SEC the power to pursue civil monetary penalties administratively with respect to violations of the 1933 Act, and not just regarding registered parties violating the 1934 Act.<sup>88</sup> This change opened a new class of potential defendants to the SEC, and the SEC began to exercise this new authority in earnest, taking an increased number of actions to its tribunals instead of federal court.<sup>89</sup> In 2015, the SEC began to reduce the number of cases it sent to its ALJs.<sup>90</sup> This pullback has been “interpreted . . . as a shift from the agency’s previous push to get more cases in front of [its own ALJs]” and as a response to the backlash against their increased use of tribunals.<sup>91</sup> For example, Judge Jed Rakoff, of the U.S.

---

86. See 15 U.S.C. §§ 78u-2(a), (b)(1) (2012) (allowing SEC to pursue civil monetary penalties in administrative hearings arising from violations of 1934 Act).

87. See 15 U.S.C. § 77h-1(a) (2006) (allowing for cease and desist orders to be issued by SEC without going to court against any person that is “violating, has violated, or is about to violate” Securities Act of 1933 “after notice and opportunity for hearing” in administrative proceeding).

88. See Dodd-Frank Act, Pub. L. No. 111-203, § 929P(a), 124 Stat. 1376, 1862 (2010) [hereinafter Dodd-Frank Act] (amending 15 U.S.C. § 77h-1 to allow SEC to seek monetary penalties in cease and desist actions filed in administrative proceedings).

89. See Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL ST. J. (Oct. 21, 2014, 9:40 AM), <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> (noting that SEC posited that changes brought about by Dodd-Frank would increase SEC Division of Enforcement’s “effectiveness and efficiency”); see also Rakoff, *supra* note 85, at 6 (“While a claim to greater efficiency by any federal bureaucracy suggests a certain chutzpah, it is hard to find a better example of what is sometimes disparagingly called ‘administrative creep’ than this expansion of the S.E.C.’s internal enforcement power.”). *But see* Urska Velikonja, *Reporting Agency Performance: Behind the SEC’s Enforcement Statistics*, 101 CORNELL L. REV. 901, 977 (2016) (“The way that the SEC counts enforcement actions filed and aggregate monetary penalties ordered consistently overstates the SEC’s enforcement outputs, masks trends, obscures real problems in enforcement, and reveals non-existent ‘problems’ that the SEC then tries to resolve.”).

90. See Jean Eaglesham, *SEC Trims Use of In-House Judges*, WALL ST. J. (Oct. 11, 2015, 9:00 PM), <http://www.wsj.com/articles/sec-trims-use-of-in-house-judges-1444611604> (“A review of 160 cases affecting more than 500 defendants shows that in the three months through September, the SEC sent just 11%—four of 36—of its contested cases to its administrative law judges. That was down from 40% in the like period of 2014. For the full fiscal year ended Sept. 30, the SEC used its internal tribunal for 28% of its contested cases, compared with 43% for the previous 12 months, according to the analysis and SEC data, both of which exclude settled and routine cases.”).

91. See *id.* (“The pullback comes on the heels of a meeting this spring in which Andrew Ceresney, SEC director of enforcement, told his senior staff it should send contested cases alleging insider trading or accounting fraud to federal court unless there were good reasons to use the SEC judges, said people close to the agency. Some familiar with the meeting interpreted the remarks as a shift from the agency’s previous push to get more cases in front of in-house judges.”).

District Court for the Southern District of New York, has argued that the SEC's increased use of their expanded administrative powers "hinders the balanced development of the securities laws."<sup>92</sup> On October 22, 2015, U.S. Congressman Scott Garrett introduced legislation in the House of Representatives to "opt out of the Securities and Exchange Commission's current enforcement proceedings" and appear in federal court, instead.<sup>93</sup> These and other challenges to the SEC's tribunals are based on several areas of concern. This Part focuses on chief criticisms of the SEC's tribunals, including allegations of insufficient procedural due process protections for tribunal defendants and bias by ALJs toward the SEC. Such opposition has been mounted by politicians, academics, legal practitioners, judges, and others.

#### A. *Lack of Due Process*

One criticism of the SEC's use of tribunals is the lack of procedural due process afforded defendants relative to that received in federal court.<sup>94</sup> Due process—in essence, basic fairness—is a fundamental part of our nation's judiciary.<sup>95</sup> While SEC tribunals are not part of the judicial branch, all branches of the U.S. government are still subject to the U.S. Constitution's Fifth Amendment guarantee that "[n]o person shall be . . . deprived of life, liberty, or property, without due process of law."<sup>96</sup> Thus, the Supreme Court has consistently held that government actions involving a broad array of liberty or property interests, even if they occur in a non-article III court, trigger procedural-due-process requirements.<sup>97</sup>

92. See Rakoff, *supra* note 85, at 11 ("In short, what you have here are broad anti-fraud provisions . . . that have historically been construed and elaborated by the federal courts but that, under Dodd-Frank, could increasingly be construed and interpreted by the S.E.C.'s administrative law judges if the S.E.C. chose to bring its more significant cases in that forum . . . . [T]his is unlikely, I submit, to lead to as balanced, careful, and impartial interpretations as would result from having those cases brought in federal court . . . . [I]t would not be good for the impartial development of the law in an area of immense practical importance.").

93. See *House Bill to Weaken SEC Enforcement Moves Ahead*, THINKADVISOR (Mar. 2, 2016), <http://www.thinkadvisor.com/2016/03/02/house-bill-to-weaken-sec-enforcement-moves-ahead> [<https://perma.cc/HPC8-24R8>]. On March 2, 2016, Rep. Garrett's bill was reported by committee for consideration by the full chamber. For the bill's current status, see *H.R. 3798 (114th): Due Process Restoration Act of 2015*, GOVTRACK, <https://www.govtrack.us/congress/bills/114/hr3798> [<https://perma.cc/ARB9-KQU3>] (last visited Jan. 20, 2017).

94. See *House Bill to Weaken SEC Enforcement Moves Ahead*, *supra* note 93 ("[I am] pleased that today the Financial Services Committee passed my bill to restore the due process rights of all Americans by allowing them to have their case before the SEC heard by a federal court." (quoting Rep. Scott Garrett)).

95. See, e.g., *In re Murchison*, 349 U.S. 133, 136 (1955) ("A fair trial in a fair tribunal is a basic requirement of due process.").

96. See U.S. CONST. amend. V.

97. See *Ingraham v. Wright*, 430 U.S. 651, 674 (1977) (holding corporate punishment administered in public school was liberty interest subject to due process constraints); *Bell v. Burson*, 402 U.S. 535, 539–40 (1971) (holding suspension or revocation of driver's license requires procedural due process); *Goldberg v. Kelly*,

However, while procedural due process is easily triggered, the Supreme Court has held that the level of due process required does not have to be comparable to the level received in an Article III court.<sup>98</sup>

In determining whether the procedure at issue satisfies the demands of due process, the Supreme Court has employed a balancing test that considers such interests as the type of liberty or property interest subject to the governmental action, the risk that the procedure used will lead to “an erroneous deprivation of such interest,” the “probable value” of more robust procedures, and the burden on the government if it must employ additional procedures.<sup>99</sup> Thus, for example, in a case involving the termination of welfare benefits, the Court held that due process required “a pre-termination evidentiary hearing” due to the type of benefits at stake and the applicant’s potential need of the benefits for subsistence.<sup>100</sup> However, in other situations, the Court has held that the liberty interest or governmental benefit at issue was not substantial enough to require an evidentiary hearing prior to the government action related to that interest.<sup>101</sup>

Thus, while it may seem fundamentally unfair for a defendant facing legal action before an SEC tribunal not to receive at least the same amount of due process that defendants facing action in federal court receive, the Supreme Court has held procedures akin to those in federal court are not the only ones that will fulfill the requirements of due process.<sup>102</sup> However, that does not mean that a procedural-due-process claim could not be successful if the procedural safeguards present do not adequately protect the defendant’s interests at stake. Thus, it is important to discuss the level of procedural process given in SEC tribunals, as compared to those in federal court, as well as the liberty interests at stake in an SEC tribunal.

With respect to the liberty and property interests at stake, they are quite severe. Under both the 1933 and 1934 Acts, the SEC can obtain

---

397 U.S. 254, 262 (1970) (holding procedural due process constraints apply to termination of welfare benefits by government agency).

98. See *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972) (“[D]ue process is flexible and calls for such procedural protections as the particular situation demands.”); *Bell*, 402 U.S. at 540 (“A procedural rule that may satisfy due process in one context may not necessarily satisfy procedural due process in every case. Thus, procedures adequate to determine a welfare claim may not suffice to try a felony charge.” (citing *Goldberg*, 397 U.S. at 270–71; *Gideon v. Wainwright*, 372 U.S. 335 (1963))).

99. See *Mathews v. Eldridge*, 424 U.S. 319, 321, 335 (1976) (discussing interests considered in determining what process is due).

100. See *Goldberg*, 397 U.S. at 264 (“Thus the crucial factor in this context . . . is that termination of aid pending resolution of a controversy over eligibility may deprive an eligible recipient of the very means by which to live while he waits.”).

101. See, e.g., *Ingraham*, 430 U.S. at 683 (holding procedural due process “does not require notice and a hearing prior to the imposition of corporal punishment in the public schools”).

102. See *supra* note 98.

significant monetary penalties via their tribunals.<sup>103</sup> Under the 1933 Act, these monetary penalties range from \$7,500 to \$150,000 per violation for natural persons and \$75,000 to \$725,000 per violation for any other person.<sup>104</sup> Under the 1934 Act, these monetary penalties range from \$5,000 to \$100,000 per violation for natural persons, and \$50,000 to \$500,000 per violation for any other person, or if greater than these ranges, the gross pecuniary gain as a result of the violation.<sup>105</sup> Depending on the number of violations alleged, the size of the monetary penalties that can be imposed is theoretically limitless. Additionally, defendants in administrative hearings face the potential for their livelihood to be disrupted or permanently taken away by the imposition of a ban from acting as an officer or director of a publicly-traded company.<sup>106</sup> Under any measure, it is difficult to argue that the liberty and property interests at stake before SEC administrative tribunals are not severe. Because the interests at stake are substantial, one would expect that the procedural due process accompanying these tribunals would be roughly equal.<sup>107</sup> Unfortunately, many critics have asserted that this is not the case and that the procedural protections found in SEC administrative tribunals fall far short of those found in federal court.

One due-process shortcoming of SEC tribunals is the limited discovery they afford defendants. Defendants facing action before an SEC tribunal are given less opportunity to gather evidence than are defendants facing action in federal courts, which adhere to the Federal Rules of Civil Procedure's rules of discovery.<sup>108</sup> These rules are designed to allow parties to the dispute great latitude in gathering evidence in order to substantiate or defend their claims.<sup>109</sup> The court does have discretion to limit discovery, such as the number of depositions taken or interrogatories allowed, but by and large, the parties are free to tailor discovery to the spe-

---

103. See 15 U.S.C. § 77h-1(g) (2012) (imposing monetary penalties in administrative hearings for violations of 1933 Act); see also 15 U.S.C. § 78u(d)(3) (2012) (imposing monetary penalties in administrative hearings for violations of 1934 Act).

104. See 15 U.S.C. §§ 77h-1(g)(1)–(2) (providing range of monetary penalties allowed in administrative hearings under 1933 Act).

105. 15 U.S.C. §§ 78u(d)(3)(B)(i)–(ii) (providing range of monetary penalties allowed in administrative hearings under 1934 Act).

106. See 15 U.S.C. § 77h-1(f); 15 U.S.C. § 77u(d)(2).

107. See *Bell v. Burson*, 402 U.S. 535, 540 (1971) (“A procedural rule that may satisfy due process in one context may not necessarily satisfy procedural due process in every case. Thus, procedures adequate to determine a welfare claim may not suffice to try a felony charge.” (citing *Goldberg v. Kelly*, 397 U.S. 254, 270–71 (1970); *Gideon v. Wainwright*, 372 U.S. 335 (1963))).

108. See FED. R. CIV. P. 26 (providing general framework for discovery in federal court).

109. See FED. R. CIV. P. 26(b)(1) (“Unless otherwise limited by court order, the scope of discovery is as follows: Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party’s claim or defense and proportional to the needs of the case . . . . Information within this scope of discovery need not be admissible in evidence to be discoverable.”).

cific needs of the case.<sup>110</sup> Additionally, because the judge is an independent adjudicator not subject to control by either party, presumably any limits placed on discovery will be decided in a relatively fair and unbiased manner.<sup>111</sup> Thus, even when one of the parties is the government in civil actions in federal court, the parties are procedurally on equal footing with respect to their ability to marshal evidence to either support their claims or defend themselves.<sup>112</sup>

By contrast, the discovery allowed to defendants in SEC administrative tribunals is far more limited. As an initial matter, the SEC has broad investigative authority to secure evidence related to a potential violation of the securities laws.<sup>113</sup> The SEC can take months, or even years, gathering evidence and mounting a case against a defendant it plans to take a case before an SEC tribunal.<sup>114</sup> However, once the proceeding is initiated, an evidentiary hearing before an SEC ALJ can occur as quickly as one month from when the SEC begins an enforcement proceeding.<sup>115</sup> Thus, from the outset, the deck seems to be stacked against the defendant from a discovery standpoint.

Discovery limits placed on defendants once a hearing is initiated further exacerbate this deck-stacking. For example, unlike defendants in federal courts, defendants subject to SEC tribunals are more limited in their ability to depose a party by oral examination.<sup>116</sup> Any party wishing to take a deposition is required to file a detailed written motion justifying the need for the deposition.<sup>117</sup> Whether to grant the motion is at the discre-

---

110. See FED. R. CIV. P. 26(f) (discussing scheduling conference of parties and creation of discovery plan for case).

111. See U.S. CONST., art. III, § 1. The Constitution's tenure and salary protections help ensure that judges are truly independent adjudicators, not beholden to any outside party.

112. See FED. R. CIV. P. Title V. The Federal Rules of Civil Procedure apply to all parties, government and non-government alike.

113. See *How Investigations Work*, *supra* note 75 ("All SEC investigations are conducted privately. Facts are developed to the fullest extent possible through informal inquiry, interviewing witnesses, examining brokerage records, reviewing trading data, and other methods. With a formal order of investigation, the Division's staff may compel witnesses by subpoena to testify and produce books, records, and other relevant documents. Following an investigation, SEC staff present their findings to the Commission for its review. The Commission can authorize the staff to file a case in federal court or bring an administrative action. In many cases, the Commission and the party charged decide to settle a matter without trial.").

114. See *id.*

115. See 17 C.F.R. § 201.360(a)(2)(ii) (2016) (providing that under shortest time period of 120 days "the hearing officer shall issue an order scheduling the hearing to begin approximately one month . . . from the date of service of the order instituting the proceeding").

116. See 17 C.F.R. § 201.233 (2016) (providing procedures for taking depositions in SEC administrative proceedings).

117. See *id.* § 201.233(a).

tion of the Commission or the presiding ALJ.<sup>118</sup> The same is true for depositions by written questions.<sup>119</sup> A party is allowed to request the issuance of a subpoena requiring attendance of a witness or production of a document, but once again, the granting of any such subpoena is within the discretion of the ALJ or other SEC officials.<sup>120</sup> Thus, if brought before an SEC administrative tribunal, a defendant can find itself involved in a proceeding against an adversary that has already conducted a thorough investigation pursuant to broad investigatory powers, but the defendant will have limited ability to engage in discovery to dispute the allegations. Further, an adjudicatory authority whose independence, due to affiliation with the agency, is questionable at best, has broad discretion as to the scope of discovery.<sup>121</sup> The difference in procedure between this proceeding and that of federal court is stark.

Once the hearing begins, the procedural shortcomings continue. The ALJ has virtually unfettered discretion regarding what evidence will be admitted, including what witnesses will be allowed and even whether those witnesses can be cross examined.<sup>122</sup> The only standard is whether evidence is relevant, as determined by the Commission or hearing officer.<sup>123</sup> Thus, for example, a hearing officer would be free to admit hearsay evidence, as long as it is deemed relevant.<sup>124</sup> These rules for evidence, admissibility, and the calling of witnesses can fairly be summed up as whatever evidence the Commission or hearing officer deems relevant to the case at hand.<sup>125</sup>

---

118. *See id.* § 201.233(b) (specifying that requests to depose are “[i]n the discretion of the Commission or the hearing officer”).

119. *See* 17 C.F.R. § 201.234 (2016) (setting forth procedure by which parties may procure depositions by written questions, which are substantially similar to those for oral depositions).

120. *See* 17 C.F.R. § 201.232 (2016) (setting forth requirements for issuance of subpoenas to compel witness testimony and discretion given to SEC official requested to issue subpoena to deny request).

121. *See infra* Part V.B.

122. *See* 17 C.F.R. § 201.320(a) (2016) (“[T]he Commission or the hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unreliable.”); *see also* 17 C.F.R. § 201.326 (2016) (“In any proceeding in which a hearing is required to be conducted on the record . . . a party is entitled to present its case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as, in the discretion of the Commission or the hearing officer, may be required for a full and true disclosure of the facts. The scope and form of evidence, rebuttal evidence, if any, and cross-examination, if any, in any other proceeding shall be determined by the Commission or the hearing officer in each proceeding.”).

123. *See* 17 C.F.R. § 201.320(a) (2016).

124. *See, e.g.,* Ernest Gellhorn, *Rules of Evidence and Official Notice in Formal Administrative Hearings*, 1971 DUKE L.J. 1, 5 (discussing “significant institutional distinctions between agencies and courts” with respect to evidentiary rules); *see also* William H. Kuehnle, *Standards of Evidence in Administrative Proceedings*, 49 N.Y.L. SCH. L. REV. 829 (2005).

125. *See* 17 C.F.R. § 201.320(a) (2016).

All of these procedural shortcomings might be forgiven, or at least overlooked, if there were an opportunity for a meaningful appeal from the hearing. However, any appeal from an SEC ALJ's initial ruling proceeds to the SEC.<sup>126</sup> Therefore, in essence, the appeal is heard by the same entity that heard the evidence and issued a ruling. Any subsequent appeal is to a federal circuit court, where the decision of the SEC is given great deference.<sup>127</sup> Findings of fact made by the Commission need to be supported only by "substantial evidence," and findings of law will not be overturned unless there is a finding of an abuse of discretion.<sup>128</sup> While such a deferential standard might be appropriate if the procedures in place at the hearing level were more adequate, given the potential for unfairness inherent in the administrative hearing procedures, the appellate review procedure provides little aid to defendants in SEC proceedings. Considering all of the procedural shortcomings present in the SEC's tribunals, Judge Jed Rakoff writes, "It is hardly surprising in these circumstances that the S.E.C. won 100% of its internal administrative hearings in the fiscal year ending September 30, 2014, whereas it won only 61% of its trials in federal court during the same period."<sup>129</sup>

Russell G. Ryan, a former assistant direct of the SEC's Division of Enforcement, writes,

Based mostly on precedent established before the SEC had any power to punish, courts have exempted SEC prosecutions from many bedrock due-process protections taken for granted in criminal cases. The presumption of innocence, for example, is largely meaningless because the SEC can win by a mere "preponderance of the evidence" rather than proof beyond reasonable

---

126. See 17 C.F.R. §§ 201.410–411 (2016) (noting that decisions in proceedings may be appealed to Commission and any such appeal is prerequisite to judicial review).

127. See *Svalberg v. SEC.*, 876 F.2d 181, 185 (1989) ("The main point is that a court should not second-guess the judgment of the Commission in connection with the imposition of sanctions, unless the SEC has acted contrary to law, without basis in fact or in abuse of discretion.").

128. See *Wonsover v. SEC.*, 205 F.3d 408, 412 (2000) (noting Commission's findings of fact are reviewed for substantial evidence and findings of law will not be overturned unless "'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law'" (quoting *Proffitt v. FDIC*, 200 F.3d 855, 860 (D.C. Cir. 2000))).

129. Rakoff, *supra* note 85, at 7; see also Robert Loeb, Jason M. Halper & Marc R. Shapiro, *Supreme Court Declines to Address the Constitutionality of Securities and Exchange Administrative Forum*, ORRICK (Mar. 30, 2016), <http://blogs.orrick.com/securities-litigation/2016/03/30/breaking-news-supreme-court-declines-to-address-the-constitutionality-of-securities-and-exchange-administrative-forum/> [https://perma.cc/XKU4-5SDM] ("The consequences of being subject to an SEC administrative review process are significant. In federal court, a defendant is entitled to full civil discovery, complete application of the Federal Rules of Civil Procedure and Evidence, in most cases, a jury trial, and adjudication by a neutral arbiter, while a respondent in a SEC proceeding is entitled to none of these protections. The results of that incongruity speak for themselves.").

doubt. The right to remain silent is equally hollow because courts let the SEC treat silence as evidence of guilt. For SEC defendants who can't afford a good lawyer, tough luck, because there's no right to have counsel appointed at government expense as there would be in a criminal prosecution. And even when the SEC loses after trial, double jeopardy doesn't prevent it from trying to reverse the verdict or force a retrial, as it would a criminal prosecutor. Dodd-Frank made things even worse by expanding the SEC's ability to impose draconian financial penalties in administrative proceedings that have lax evidentiary rules, no jury trial, and limited judicial oversight.<sup>130</sup>

Not surprisingly, procedural-due-process claims have been brought against the SEC and are pending. In a recent case, George Jarkesy Jr. and his Patriot28 fund filed a suit seeking a preliminary injunction barring the SEC "from proceeding with an administrative proceeding" on due-process grounds.<sup>131</sup> This case involves an SEC enforcement action brought in an administrative tribunal, alleging violations of the 1933 and 1934 Acts and seeking monetary penalties and other relief.<sup>132</sup> Among the many procedural irregularities and constitutional violations alleged by the plaintiffs, including an equal protection claim,<sup>133</sup> the plaintiffs raise due process issues arising from the procedural deficiencies inherent in the SEC's administrative tribunal Rules of Practice, including:

that the SEC's short schedules between service and the date of the hearing do not provide adequate time to prepare a defense;<sup>134</sup>

that the Commission adjudged them guilty before the date of the hearing by making findings of fact and conclusions of law against them in a settlement order entered into by plaintiffs in the case;<sup>135</sup> and

---

130. See Russell G. Ryan, *When Regulators Think They're Prosecutors*, WALL ST. J., (Apr. 8, 2014, 7:27 PM), <http://www.wsj.com/articles/SB10001424052702303978304579471273139675110>.

131. See Complaint at 1, *Jarkesy v. SEC*, 48 F. Supp. 3d 32 (D.D.C. Jan. 29, 2014) (No. 1:14-cv-00114-BAH).

132. See *id.* at 3–4 ("The Division seeks disgorgement of fees, lifetime securities-industry and officer-and-director bars, \$100 million in penalties, and a cease-and-desist order.").

133. See *id.* at 7–10 (arguing that SEC's charging plaintiffs in administrative tribunal, rather than in federal court, deprived them of equal protection where others had been charged in federal court and given jury trial).

134. See *id.* at 5 (noting that SEC's rules of practice allow only up to 300 days from service to prepare for trial, "regardless of the complexity of the issues").

135. See *id.* at 6–7 (discussing SEC's findings of fact made in Commission order entered in before date of hearing involving plaintiffs).



that the SEC provided them with “700 gigabytes[ ] of data” obtained during their investigation that “could not possibly” be reviewed within the timeframe for when the hearing would be held, and refused to disclose what exculpatory or impeachment materials were in the data.<sup>136</sup>

The plaintiffs’ request for an injunction was denied at the trial level not for substantive reasons, but rather because the district court determined it did not have subject matter jurisdiction to hear the claim because the statutory scheme at issue provided a specific appeals process.<sup>137</sup> Thus, the district court ruled that the plaintiffs would have “to raise all of their constitutional claims” in the administrative proceeding, and then appeal to the Court of Appeals if the result was “adverse to them.”<sup>138</sup> As a result of the SEC administrative proceeding, *Jarkesy and Patriot 28* were ruled to have violated the securities laws, and their constitutional claims were denied.<sup>139</sup> The Court of Appeals for the D.C. Circuit affirmed the district court’s holding that the securities laws provide for a specific adjudication and appeals process that did not allow for the filing of a federal court case challenging the constitutionality of a pending administrative proceeding.<sup>140</sup> While the court did not reach the merits of the due process claims in this case, the case illustrates the procedural problems alleged against the SEC’s use of administrative tribunals.

Presumably in response to the rising tide of criticism about the fairness of their tribunals, on September 24, 2015, the SEC proposed certain changes to their Rules of Practice.<sup>141</sup> The proposed changes include extending the time defendants have to prepare for the evidentiary hearing

---

136. *See id.* at 12–13 (noting that SEC rules of practice require SEC to disclose any exculpatory or impeachment materials gathered in investigation and alleging that SEC refused to do so).

137. *See Jarkesy v. SEC*, 48 F. Supp. 3d 32, 40 (D.D.C. 2014), *aff’d*, 803 F.3d 9 (2015). In affirming the decision of the district court, the D.C. Circuit stated, “[t]he court concluded that Congress, by establishing a detailed statutory scheme providing for an administrative proceeding before the Commission plus the prospect of judicial review in a court of appeals, implicitly precluded concurrent district-court jurisdiction over challenges like *Jarkesy’s*.” *See Jarkesy v. SEC*, 803 F.3d 9, 12 (2015).

138. *See Jarkesy*, 48 F. Supp. 3d at 38.

139. *See id.* at 35.

140. *See Jarkesy*, 803 F.3d at 30 (“We hold that the securities laws provide an exclusive avenue for judicial review that *Jarkesy* may not bypass by filing suit in district court.”).

141. *See* Press Release, Sec. & Exch. Comm’n, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015), <http://www.sec.gov/news/pressrelease/2015-209.html> [<https://perma.cc/66GD-ZRDG>] (“The proposed amendments seek to modernize our rules of practice for administrative proceedings, including provisions for additional time and prescribed discovery for the parties.” (quoting Mary Jo White, SEC Chair)); *see also* Amendments to the Commission’s Rules of Practice, 80 Fed. Reg. 60,091 (Oct. 5, 2015).

and allowing parties limited opportunity to take depositions.<sup>142</sup> The SEC's proposal notes that the agency has, from time to time, amended its Rules of Practice, but this occasion is unique in that it appears to respond to growing public criticism.<sup>143</sup> However, some critics say the changes do not go far enough and still leave defendants well short of the range of procedural protections afforded by federal courts.<sup>144</sup> Furthermore, the consensus among those who submitted comments to the SEC's proposed rule changes was that such changes were inadequate.<sup>145</sup>

On July 13, 2016, the SEC amended its Rules of Practice (changes effective September 27, 2016).<sup>146</sup> Regarding the changes, then SEC Chair Mary Jo White stated, "[t]he amendments to the Commission's rules of practice provide parties with additional opportunities to conduct depositions and add flexibility to the timelines of our administrative proceedings, while continuing to promote the fair and timely resolution of the

---

142. See SEC Proposes to Amend Rules Governing Administrative Proceedings, *supra* note 141 (describing proposed amendments to rules of practice to change timing of practice, as well as rules of discovery).

143. See Jean Eaglesham, *SEC Gives Ground on Judges*, WALL ST. J. (Sept. 24, 2015, 8:03 PM), <http://www.wsj.com/articles/sec-gives-ground-on-judges-1443139425> (noting that rule change "marks the first time the agency has publicly ceded ground to the swelling ranks of critics of its internal court, a group that includes federal judges, former SEC officials and business groups").

144. See Peter K.M. Chan et. al., *Morgan Lewis Discusses Tweaking the "Home Court" Rules for SEC Administrative Proceedings*, CLS BLUE SKY BLOG (Oct. 14, 2015), <http://clsbluesky.law.columbia.edu/2015/10/14/morgan-lewis-discusses-tweaking-the-home-court-rules-for-sec-administrative-proceedings/> [<https://perma.cc/F9FL-8N2Y>] (discussing proposed rule changes but noting they do nothing to address "core question[s]" of fairness, such as independence of ALJs); *Why the SEC's Proposed Changes to Its Rules of Practice Are Woefully Inadequate—Part I*, SEC. DIARY (Oct. 8, 2015), <http://securitiesdiary.com/2015/10/08/why-the-secs-proposed-changes-to-its-rules-of-practice-are-woefully-inadequate-part-i/> [<https://perma.cc/QWU3-N39D>] (criticizing SEC's proposed rule and giving them "F+" with respect to addressing issues of fairness and due process); William F. Johnson, *SEC Behind Times in 'Modernizing' Administrative Proceedings*, N.Y.L.J. (Nov. 4, 2015), [http://www.kslaw.com/imageserver/KSPublic/library/publication/2015articles/11-05-15\\_New-York-Law-Journal\\_Johnson.pdf](http://www.kslaw.com/imageserver/KSPublic/library/publication/2015articles/11-05-15_New-York-Law-Journal_Johnson.pdf) [<https://perma.cc/BGK7-Q29K>] ("These proposals, although a step in the right direction, still do not go far enough to leveling the playing field for respondents.").

145. See Alison Frankel, *SEC to Vote Wednesday on Rule Changes for Administrative Proceedings*, REUTERS (July 11, 2016), <http://blogs.reuters.com/alison-frankel/2016/07/11/sec-to-vote-wednesday-on-rule-changes-for-administrative-proceedings/> [<https://perma.cc/68TR-ZQ6A>] ("Only a dozen commenters submitted a response to the SEC's invitation to address the proposal, all of them defense lawyers or business groups. Their universal theme: It's progress that the SEC has recognized flaws in its administrative proceedings but the agency's proposals don't come close to fixing the problem.").

146. See Amendments to the Commission's Rules of Practice, Exchange Act Release No. 34-78319, <https://www.sec.gov/rules/final/2016/34-78319.pdf> [<https://perma.cc/CK8Z-F9Q7>].

proceedings.”<sup>147</sup> According to the SEC’s press release, “the Commission adopted final amendments that, among other things” seek to:

[e]xtend the potential length of the prehearing period from the current four months to a maximum of 10 months for the cases designated for the longest timelines[.]

[a]llow parties in the cases designated for the longest timelines the right to notice three depositions per side in single-respondent cases and five depositions per side in multi-respondent cases, and to request an additional two depositions[.]

[c]larify the types of dispositive motions that may be filed at various stages of proceedings and the applicable procedures and legal standards for the motions [and]

[m]ake additional clarifying and conforming changes to other rules, including rules regarding the admissibility of certain types of evidence, expert disclosures and reports, the requirements for the contents of an answer, and procedures for appeals.<sup>148</sup>

#### B. *Bias*

Another criticism of the SEC’s system of administrative enforcement that is intertwined with due-process concerns is that it is inherently biased toward the SEC.<sup>149</sup> As mentioned above, the evidentiary hearing is presided over by an employee, the ALJ, of the very agency that brought the enforcement action, and the first level of appeal is heard by that same agency.<sup>150</sup> Thus, the SEC brings the action, an employee who does not enjoy Article III’s tenure and salary protections rules on the evidence, and the first appeal is heard by the agency.<sup>151</sup> It is easy to see why many feel such a system is biased against defendants.<sup>152</sup>

---

147. Press Release, Sec. & Exch. Comm’n, SEC Adopts Amendments to Rules of Practice for Administrative Proceedings (July 13, 2016), <https://www.sec.gov/news/pressrelease/2016-142.html> [<https://perma.cc/63FF-QWND>] (quoting Mary Jo White, then SEC Chair).

148. *Id.*

149. See Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES (Oct. 5, 2013), <http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html> [<https://perma.cc/QXL7-NXJR>].

150. See *supra* Part V.A.

151. For a discussion of such differences between Article III courts and administrative tribunals, see Pfander, *supra* note 44.

152. See Kimberley A. Strassel, *The SEC Plays Judge and Jury*, WALL ST. J. (Aug. 4, 2016, 7:30 PM), <http://www.wsj.com/articles/the-sec-plays-judge-and-jury-1470353410> (“Ever since the Dodd-Frank financial ‘reform,’ the SEC has been pushing more cases toward in-house administrative-law judges. These judges are hired by the SEC and sit on the commission’s payroll. They have ultimate discretion over the cases they handle, and the rules severely limit discovery and deposi-

Evidence of the SEC's success rate for actions before its tribunals versus actions in federal court supports such bias claims. For example, *The Wall Street Journal* reported that the SEC enjoys a 90% success rate in its own hearings but has only a 69% success rate "against defendants in federal court."<sup>153</sup> Likewise, *the New York Times* reported similar statistics reflecting a higher win percentage in SEC administrative hearings than in federal court.<sup>154</sup> The SEC's success rate for actions brought before particular ALJs has been reported as even higher than this overall average.<sup>155</sup> The appellate statistics from direct appeals before the SEC, meaning appeals from an ALJ's decision to the Commission itself, are equally dire for defendants.<sup>156</sup> In some situations, exercising this right of appeal resulted in a worse outcome for defendants when the Commission increased the initial penalty.<sup>157</sup> Given these findings and the Dodd-Frank Act's grant of increased authority to use in-house administrative proceedings, it should

---

tions. In short, President Obama's SEC gets to sit as prosecutor, judge and jury—and no surprise that the agency loves this setup.”).

153. See Jean Eaglesham, *SEC Wins with in-House Judges*, WALL ST. J. (May 6, 2015, 10:30 PM), <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803> (“The SEC won against 90% of defendants before its own judges in contested cases from October 2010 through March of [2015], according to the Journal analysis. That was markedly higher than the 69% success the agency obtained against defendants in federal court over the same period, based on SEC data. Going back to October 2004, the SEC has won against at least four of five defendants in front of its own judges every fiscal year.”).

154. See Morgenson, *supra* note 6 (“So far this year, the S.E.C. has a better record in federal court. It won all four of its cases there while prevailing in four out of five proceedings administratively, an 80 percent success rate.”).

155. See Eaglesham, *supra* note 153 (“[N]o defendant has escaped unscathed before SEC Judge Cameron Elliot, the judge who heard Mr. Shapiro's case. In Mr. Elliot's four years as an SEC judge, he has found all of the 28 defendants who came before him in contested cases liable on at least some of the charges the SEC enforcement arm had brought against them. This compares to an 85% SEC win rate in cases before another in-house judge, Carol Foelak, and 87% in cases heard by the agency's chief administrative law judge, Brenda Murray.”).

156. *See id.* (“The commissioners decided in their own agency's favor concerning 53 out of 56 defendants in appeals—or 95%—from January 2010 through this past March, the Journal found. Five other cases were sent back to in-house SEC judges to reconsider . . . SEC officials believe appeals within the agency aren't as one-sided as the Journal's analysis suggests, according to people close to the agency. Several appeals involved cases where the underlying conduct wasn't in dispute, such as appeals of industry bans. Stripping those out, the SEC decided appeals in its own favor 88% of the time, rather than 95%. For comparison, U.S. attorneys had an average win rate of 84% before federal appellate courts in the past three fiscal years, according to Justice Department data. That rate applies to criminal cases, in contrast to the SEC's civil cases.”).

157. *See id.* (“Defendants who appealed risked making their situations even worse. During the same stretch, the SEC Commissioners reduced financial sanctions imposed on one defendant but increased the sanctions for seven others.”).

not be surprising that the SEC has increased its use of in-house enforcement in lieu of taking actions to federal court.<sup>158</sup>

Combined with the fact that the ALJs are SEC employees who lack Article III's tenure and salary protections, the SEC's recent success rate in administrative proceedings before ALJs versus that in federal district court at least arouses the perception of ALJs' possible bias toward the SEC.<sup>159</sup> It should also be noted that the SEC's in-house success rate could give it increased leverage during settlement talks with defendants. In other words, if the SEC threatens defendants with administrative actions, where they enjoy a high success rate, those defendants might be more likely to settle actions they might otherwise have contested.

These allegations of bias resulted in an internal investigation, initiated on June 30, 2015, of SEC ALJs by the SEC's Inspector General.<sup>160</sup> The most specific claim of bias made was that of Lillian McEwen, a former SEC ALJ who claims that she was "pressured" by Chief ALJ Brenda Murray "to make rulings in certain ways."<sup>161</sup> In various news outlets, McEwen has made claims that the SEC ALJ system was biased against defendants and that her loyalty was "questioned" because she ruled "too often" against the SEC.<sup>162</sup> When interviewed by the Inspector General, Chief ALJ Murray denied any bias and denied that she influenced the ALJ's rulings in any

158. *See id.* ("The SEC brought more than four out of five of its enforcement actions as administrative proceedings, rather than federal-court cases, in the fiscal year ended Sept. 30. That was up from less than half of them a decade earlier.").

159. *See* Morgenson, *supra* note 149 ("If you get caught up in the web of an agency investigation, you're investigated, prosecuted and judged by agency personnel . . . . Even if it doesn't create actual bias, it doesn't look good." (internal quotation marks omitted) (quoting Ronald J. Riccio, professor of constitutional law at Seton Hall Law School)). *But see* David Zaring, Op-Ed, *S.E.C.'s in-House Judges Not Too Tough, a Review Shows*, N.Y. TIMES (Aug. 31, 2015), [http://www.nytimes.com/2015/09/01/business/dealbook/secs-in-house-judges-not-too-tough-a-review-shows.html?\\_r=0](http://www.nytimes.com/2015/09/01/business/dealbook/secs-in-house-judges-not-too-tough-a-review-shows.html?_r=0) [<https://perma.cc/77V9-C3VU>] ("I read every decision issued by the S.E.C.'s administrative law judges from the enactment of Dodd-Frank in 2010 to March of [2015]. Graded toughly—on whether the S.E.C. received everything it wanted from the case—the agency's rate of success is high, but not unblemished . . . . Much of the agency's success before the administrative law judges, moreover, can be attributed to the routine nature of most of the cases filed administratively."); *see also* David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155 (2016) (arguing SEC has authority to act in federal court or administrative tribunals).

160. *See generally* Memorandum from Carl W. Hoecker, Inspector Gen., Sec. & Exch. Comm'n, to Mary Jo White, Chair, Sec. & Exch. Comm'n, on Interim Report on ALJ Investigation (Aug. 7, 2015), <https://www.sec.gov/oig/reportspubs/oig-sec-interim-report-investigation-admin-law-judges.pdf> [<https://perma.cc/FPZ6-BE2Q>] (noting that investigation was initiated due to "heightened interest[ ] in ongoing [SEC] administrative proceedings," including "allegations of bias").

161. *See id.* at 2–3.

162. *See id.* at 3 (noting statements attributed to McEwen, including "she thought the system was slanted against defendants at times; she came under fire from Chief ALJ Murray for finding too often in favor of defendants; Chief ALJ Murray questioned McEwen's loyalty to the SEC; McEwen retired as a result of criticism; and SEC judges were expected to work on the assumption that 'the bur-

way.<sup>163</sup> The investigation's interim report, issued August 7, 2015, noted that the Inspector General had not yet discovered any evidence of bias.<sup>164</sup> The final report, issued January 21, 2016, indicated the same conclusion:

The OIG did not develop any evidence to support the allegations of improper influence. Former and current staff affiliated with the Office of ALJs, including McEwen, stated that ALJ decisions were made independently and free from influence of SEC Chief ALJ Murray. Conversely, several individuals interviewed during this investigation indicated that Murray emphasized fairness and independence of the Office, and some noted only systemic factors that impacted complete adjudicative independence, such as Commission precedent and the rules of practice.<sup>165</sup>

Any defendant raising a procedural due process claim based upon bias faces a difficult road. The Supreme Court has held that procedural due process requires an unbiased decision-maker at hearings.<sup>166</sup> Moreover, this requirement has been expressly held to apply to administrative hearings.<sup>167</sup> However, in the context of administrative hearings, the Supreme Court has set the standard for lack of bias quite low. For example, the Supreme Court has expressly held that even when the same individuals within an agency engage in the investigation and adjudication of a claim against the alleged violator, this fact alone does not show sufficient bias to violate due process.<sup>168</sup> In administrative settings, the Supreme Court has presumed that those adjudicating claims are unbiased, absent some particular facts that indicate greater bias than mere association with the agency, such as a pecuniary interest in the outcome.<sup>169</sup> Based upon this precedent, broad allegations of bias based upon statistics showing that the SEC

---

den was on the people who were accused to show that they didn't do what the agency said they did").

163. *See id.* at 4.

164. *See id.*

165. Memorandum from Carl W. Hoecker, Inspector Gen., Sec. & Exch. Comm'n, to Mary Jo White, Chair, Sec. & Exch. Comm'n, on Final Report on ALJ Investigation (Jan. 21, 2016), <https://www.sec.gov/oig/reportspubs/Final-Report-of-Investigation.pdf> [<https://perma.cc/Q8XB-GXNZ>].

166. *See In re Murchison*, 349 U.S. 133, 136 (1955) ("A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness.").

167. *See Withrow v. Larkin*, 421 U.S. 35, 47-48 (1974) ("This applies to administrative agencies which adjudicate as well as to courts." (citing *Gibson v. Berryhill*, 411 U.S. 564, 579 (1973))).

168. *See id.* at 47 ("The contention that the combination of investigative and adjudicative functions necessarily creates an unconstitutional risk of bias in administrative adjudication has a much more difficult burden of persuasion to carry.").

169. *See id.* (noting absent pecuniary interest or similar interest, accusations of bias must "overcome a presumption of honesty and integrity in those serving as adjudicators").

wins more often in its administrative courts than in federal court are unlikely to be sufficient to show bias in violation of due process.<sup>170</sup>

### C. *Appointments Clause*

Though not a key focus of this Article—yet worthy of its own article—another angle of opposition to the SEC’s tribunals is the argument that the SEC’s process of appointing ALJs violates the U.S. Constitution’s Appointments Clause.<sup>171</sup> The Appointments Clause grants the President the power to appoint, “with the Advice and Consent of the Senate,” officers of the United States, but it also allows that “Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.”<sup>172</sup> While determining exactly which government officers are subject to the Appointments Clause can be difficult, the Supreme Court has focused on the level of authority exercised as the test for making this determination.<sup>173</sup> SEC ALJs are not appointed by any of the three parties specified in the Appointments Clause, but rather by the SEC’s Office of Administrative Law Judges, following candidate recommendations by the OPM.<sup>174</sup> Thus, defendants in SEC administrative proceedings have challenged the constitutionality of ALJs’ appointments. Addressing such Appointments Clause criticisms, the SEC does not take the position that its ALJs are appointed in accordance with the Appointments Clause, but rather that the Appointments Clause does not apply because the ALJs are employees and not inferior officers.<sup>175</sup>

In one noteworthy case, *Bebo v. SEC*,<sup>176</sup> plaintiff Laurie Bebo challenged the SEC’s use of administrative tribunals on the grounds that such tribunals do not adhere to the requirements of the Appointments

---

170. See *Schweiker v. McClure*, 456 U.S. 188, 195–96 (1982) (noting that analysis for impartiality begins with “presumption that the hearing officers . . . are unbiased” and party asserting bias bears burden of rebutting presumption by showing some specific reason for disqualification (citations omitted)).

171. See U.S. CONST. art. II, § 2, cl.2.

172. See *id.*

173. See, e.g., *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (“We think that the term ‘Officers of the United States’ . . . is a term intended to have substantive meaning. We think its fair import is that any appointee exercising significant authority pursuant to the laws of the United States is an ‘Officer of the United States,’ and must, therefore, be appointed in the manner prescribed by [Section] 2, cl. 2, of that Article.”), *superseded by statute as stated in* *McCormell v. Fed. Election Comm’n*, 540 U.S. 93 (2003), *overruled by* *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310 (2010).

174. See Notice of Filing at 2, *In re Timbervest, LLC*, No. 3-15519 (June 4, 2015), <https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf> [<https://perma.cc/82L5-VRK5>] (describing appointment process for SEC ALJs).

175. See *id.* at 1 n.1 (“Respondent’s contention that ALJ Elliot’s hiring violated the Appointments Clause rests on the false premise that he is an inferior constitutional officer. As the Division has explained, ALJ Elliot is an employee, not an inferior officer.” (citation omitted)).

176. 799 F.3d 765 (7th Cir. 2015).

Clause.<sup>177</sup> On the SEC's motion for summary judgment, the U.S. District Court for the Eastern District of Wisconsin dismissed Bebo's claim "for lack of subject matter jurisdiction."<sup>178</sup> The U.S. Court of Appeals for the Seventh Circuit upheld the dismissal.<sup>179</sup> The Seventh Circuit held that "[i]t is 'fairly discernible' from the statute that Congress intended plaintiffs in Bebo's position 'to proceed exclusively through the statutory review scheme' set forth in 15 U.S.C. § 78y . . . . If aggrieved by the SEC's final decision, Bebo will be able to raise her constitutional claims in this circuit or in the D.C. Circuit."<sup>180</sup> In 2016, the Supreme Court denied certiorari.<sup>181</sup>

Other cases, however, have yielded different outcomes at the trial level.<sup>182</sup> In one case, U.S. District Judge Leigh Martin May granted a plaintiff's request for a temporary restraining order against the SEC's administrative enforcement proceeding while she considered the plaintiff's argument that the SEC's tribunals are unconstitutional.<sup>183</sup> Among other issues before her, Judge May addressed the plaintiff's argument that SEC ALJs are not employees but rather "inferior officers" whose appointments are not in accordance with the Appointments Clause.<sup>184</sup> She noted that this determination "depends on the [amount of] authority" exercised by the ALJ "in conducting [the] proceedings."<sup>185</sup> The judge held that the SEC ALJs are indeed inferior officers because they possess significant authority, with the ability to "take testimony, conduct trial[s], rule on the

177. *See id.* at 767.

178. *See Bebo v. SEC*, No. 15-C-3, 2015 WL 905349, at \*4 (E.D. Wis. Mar. 3, 2015), *aff'd*, 799 F.3d 765 (7th Cir. 2015).

179. *See Bebo*, 799 F.3d at 775.

180. *See id.* at 767.

181. *See Bebo v. SEC*, 136 S. Ct. 1500 (2016).

182. *See Loeb, Halper & Shapiro, supra* note 129 ("So far, the lower courts have decided these constitutional challenges inconsistently. The D.C. Circuit has affirmed a dismissal for lack of jurisdiction just like the Seventh Circuit did in *Bebo*. A few courts in the Southern District of New York have done the same. However, one Southern District of New York judge went the other way, holding that the court had subject matter jurisdiction to hear the case, and then also finding in favor of the petitioner and granting a preliminary injunction against the SEC enjoining the administrative tribunal proceedings. District courts in Georgia have also granted preliminary injunctions halting SEC administrative proceedings." (citations omitted)).

183. *See Hill v. SEC*, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015), *vacated and remanded*, 825 F.3d 1236 (11th Cir. 2016). For a more specific discussion of *Hill* in the context of the constitutional issues surrounding SEC proceedings, see Thomas Glassman, *Ice Skating up Hill: Constitutional Challenges to SEC Administrative Proceedings*, 16 J. Bus. & Sec. L. 47 (2016).

184. *See id.* at 1316–21 (noting that success of plaintiff's Appointments Clause argument in case rested upon whether ALJs are inferior officers).

185. *See id.* at 1316 ("The issue of whether the SEC ALJ is an inferior officer or employee for purposes of the Appointments Clause depends on the authority he has in conducting administrative proceedings.").



admissibility of evidence, and can issue sanctions.”<sup>186</sup> She noted that these powers are “nearly identical” to powers that the Supreme Court had previously held to be “sufficient to find [special trial judges (STJ) in Tax Court] were inferior officers.”<sup>187</sup>

The SEC argued that “Congress intended ALJs to be employees,” not inferior officers, and thus the court should defer to Congress’s intent.<sup>188</sup> However, the court dispensed with this argument quite quickly, explaining that Congressional intent is always subject to the Constitution, in this case the Appointments Clause.<sup>189</sup> Thus, the judge held that even if Congress’s intent was to make ALJs employees, it could not simply call them employees, allow for their appointment outside of the strictures of the Appointments Clause, and still vest them with the power of inferior officers.<sup>190</sup> Based upon the court’s holding that ALJs are inferior officers, and because the SEC conceded that they were not appointed in accordance with the Appointments Clause, Judge May held that the plaintiffs “ha[d] established a likelihood of success on the merits” to justify a preliminary injunction staying the proceedings.<sup>191</sup> After the decision, the same court issued similar rulings enjoining SEC enforcement proceedings against Gray Financial Group<sup>192</sup> and Ironridge Global IV, Ltd.<sup>193</sup>

---

186. *See id.* at 1317 (“ALJs are permanent employees—unlike special masters—and they take testimony, conduct trial, rule on the admissibility of evidence, and can issue sanctions, up to and including excluding people (including attorneys) from hearings and entering default.” (citing 17 C.F.R. §§ 200.14, 201.180 (2016))).

187. *See id.* at 1318 (“Similarly, this Court concludes that the Supreme Court in *Freytag* found that the STJs powers—which are nearly identical to the SEC ALJs here—were independently sufficient to find that STJs were inferior officers.” (citing *Butz v. Economou*, 438 U.S. 478, 513 (1978))).

188. *See id.* at 1319 (“In the SEC’s view, Congress is presumed to know about the Appointments Clause, and it decided to have ALJs appointed through OPM and subject to the civil service system; thus, Congress intended for ALJs to be employees according to the SEC.”).

189. *See id.* (“But ‘[t]he Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint.’” (quoting *Freytag v. Comm’r*, 501 U.S. 868, 880 (1991))).

190. *See id.* (“Congress may not ‘decide’ an ALJ is an employee, but then give him the powers of an inferior officer; that would defeat the separation-of-powers protections the Clause was enacted to protect. The Court finds that SEC ALJs are inferior officers.”).

191. *See id.* (“Because SEC ALJs are inferior officers, the [c]ourt finds Plaintiff has established a likelihood of success on the merits on his Appointments Clause claim. Inferior officers must be appointed by the President, department heads, or courts of law. Otherwise, their appointment violates the Appointments Clause.” (citation omitted)).

192. *See Gray Fin. Grp., Inc. v. SEC*, 166 F. Supp. 3d 1335 (N.D. Ga. 2015), *vacated and remanded sub nom. Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016).

193. *See Ironridge Global IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294 (N.D. Ga. 2015), *appeal filed*, No. 16-10205 (11th Cir. Jan. 19, 2016).

In another case, the district judge granted a preliminary injunction against the SEC on Appointments Clause grounds.<sup>194</sup> The court had previously given the SEC seven days “to allow the SEC the opportunity to notify the Court of its intention to cure any violation of the Appointments Clause,” noting that the SEC ALJ’s appointments were “likely unconstitutional.”<sup>195</sup> Drawing upon Judge May’s findings in *Hill*, the court ruled ALJs are inferior officers.<sup>196</sup> Thus, their appointments must comport with the Appointments Clause in order to be constitutional.<sup>197</sup> Though the Supreme Court denied certiorari in *Bebo v. SEC*, the Court may eventually decide the Appointments Clause issue on the merits.<sup>198</sup>

Though it is not an issue central to our recommendations, it is worth noting that both decisions discussed above addressed a possible solution to the Appointments Clause problem presented by SEC tribunals: having the SEC commissioners directly appoint ALJs.<sup>199</sup> Doing so would presumably comport with the Appointments Clause because the SEC’s commissioners are, indeed, the heads of a department.<sup>200</sup> However, revising the manner of appointing ALJs to comport with the Constitution’s mandate could create a host of problems of its own. Adopting the solution pro-

---

194. *See Duka v. SEC*, 124 F. Supp. 3d 287, 290 (S.D.N.Y. 2015) (“Because the Court finds Plaintiff has demonstrated irreparable harm along with substantial likelihood of success on the merits of her claim that the SEC has violated the Appointments Clause, the Court finds a preliminary injunction is appropriate to enjoin the SEC administrative proceeding.”), *vacated and remanded*, No. 15-2732 (2d Cir. June 13, 2016).

195. *See Duka v. SEC*, No. 15 Civ. 357(RMB) (SN), 2015 WL 4940057, at \*3 (S.D.N.Y. Aug. 3, 2015).

196. *See Duka*, 124 F. Supp. 3d at 289–90.

197. *See id.* at 289 (“Under the Appointments Clause in Article II: ‘[T]he Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.’ It is well-settled that the Appointments Clause provides the exclusive means by which inferior officers may be appointed . . . . Therefore, as SEC [ALJs] are inferior officers, their appointments must be made by the President, courts of law, or department heads.” (citations omitted)).

198. *See Loeb, Halper & Shapiro, supra* note 129 (“With all of these divergent outcomes, the issue very well may wind its way to the Supreme Court. However, the Supreme Court will probably let most of these cases play out in the lower courts before weighing in, or at least will allow a circuit split to develop before taking up the issue. The earliest that could happen would be when either the Second Circuit or the Eleventh Circuit decides the appeals pending before them.”).

199. *See Gray Fin. Grp., Inc. v. SEC*, 166 F. Supp. 3d 1335, 1355 (N.D. Ga. 2015) (“The Court notes that this conclusion may seem unduly technical, as the ALJ’s appointment could easily be cured by having the SEC Commissioners issue an appointment or preside over the matters themselves.”); *see also Duka v. SEC*, 124 F. Supp. 3d 287, 289, 289 n.1 (S.D.N.Y. 2015) (noting district court’s ruling, that appointment issue could be easily cured, and giving parties seven days to remedy violation before issuing injunction).

200. *See Free Enter. Fund, LLP v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 511–13 (2010) (holding SEC commissioners are heads of department for purposes of Appointments Clause).

posed by Judge May and Judge Berman could be seen as evidence that the SEC's current system of appointments is constitutionally deficient and, thus, "call into question the outcome" of past rulings by, and current proceedings before, ALJs.<sup>201</sup> Moreover, the same could be true for past and present defendants in actions brought by other agencies that appoint ALJs in the same manner used by the SEC.<sup>202</sup>

Even if the Appointments Clause problem might be easily solved, doing so would not remedy the other problems addressed above. In other words, even if the SEC commissioners directly appointed SEC ALJs, concerns about the lack of due process, problematic rules of evidence, and bias would still be present. As such, eliminating any Appointments Clause problems would still leave us in a situation where legitimate procedural problems would justify a wholesale revamping of the tribunals. Part III proposes various solutions Congress could enact that would remedy many of the complaints raised about the SEC tribunal system.

### III. RECOMMENDATIONS FOR REFORM

Given the problems associated with the SEC's system of in-house adjudication, reform is needed. Even if the SEC resolved the Appointments Clause issue, the other negatives of the SEC's in-house enforcement actions justify the creation of an adjudicatory framework that lies outside of the SEC. Furthermore, even if the SEC revised its procedural rules to be in line with those employed by the federal courts, challenges of bias and concerns about the legitimacy of legal actions outside of the judicial branch would remain. These issues highlight the importance of the time-honored principle that the judicial function should be separate from and independent of the other branches of government.<sup>203</sup> This Article questions the wisdom and constitutionality of the ALJ system as a whole on this principle, regardless of its seeming acceptance as constitutional by fiat based upon its convenience and long existence.<sup>204</sup> We argue that these separation of powers concerns are even greater in the area of securities and financial regulation, as the key role of a financial regulator is to preserve the integrity of the market so the financial system can function prop-

201. See Alison Frankel, *Why the SEC Can't Easily Solve Appointments Clause Problem with ALJs*, REUTERS (June 17, 2015), <http://blogs.reuters.com/alison-frankel/2015/06/17/why-the-sec-cant-easily-solve-appointments-clause-problem-with-aljs/> [<https://perma.cc/M5UP-XK8K>] (discussing potential negative implications to SEC operations and cases if appointment process were changed).

202. See *id.* ("[I]f the SEC tacitly concedes its in-house judges were unconstitutionally appointed . . . other federal agencies are also going to have to look hard at the duties and appointment processes for their administrative law judges.")

203. See *supra* Part I.A. (discussing importance of separation of powers and independent judiciary).

204. See Pfander, *supra* note 44, at 775 (noting that literal reading of Constitution would not allow for non-article III judicial power and that few support such literal reading because it seems "unthinkable to those who recognize and accept the vast scope of the administrative state").

erly for all.<sup>205</sup> Preserving market integrity requires integrity of the regulator, as well as of the regulated. Maintaining judicial power within the regulator itself in such a high-stakes area undercuts the perception, and perhaps reality, of the regulator's integrity.

Simply because the Supreme Court has ruled that administrative tribunals pass constitutional muster does not mean Congress is required to create them. There are better methods for adjudication of these disputes that honor our well-accepted traditions and constitutional requirements of fair trials and an independent judiciary.<sup>206</sup> To that end, this Part proposes several alternatives to the current system. Though this Article advocates chiefly for Article III federal courts of specialty jurisdiction to hear securities disputes, each of these options is preferable to the current system.

#### A. *Basic Solutions: Utilize Existing Federal Courts*

To be sure, one easy solution already exists: U.S. District Courts. Congress could simply amend the securities laws to require any SEC enforcement action, or a subset of actions, such as those seeking any cease-and-desist order or monetary penalty, to be filed in a U.S. District Court and do away with administrative proceedings altogether. This change would solve constitutional issues with the current system, provide private parties with a fair forum for enforcement litigation, and be an easy change, logistically, because it takes advantage of the existing federal court system and would not require the creation of new courts with new buildings, employees, judges, or procedural rules. However, this solution has problems, given the nature and volume of securities enforcement proceedings.

The SEC reports that it files a high volume of securities enforcement cases.<sup>207</sup> Thus, it would appear at first blush that requiring the SEC to file all of its enforcement actions in federal court might be overwhelming due to the volume of cases that would be added to an already backlogged system of federal trial courts. However, as one scholar recently noted, a more detailed analysis of the SEC's enforcement statistics reveals that they

205. See INT'L ORG. OF SEC. COMM'NS, MITIGATING SYSTEMIC RISK: A ROLE FOR SECURITIES REGULATORS 3 (2011), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD347.pdf> [<https://perma.cc/EP2C-9ASJ>] ("Securities regulators have a key role to play in addressing systemic risk, bringing their particular perspective as market integrity regulators . . . . The recent financial crisis has led securities regulators to put greater emphasis on systemic risk and financial stability.").

206. See, e.g., *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 57 (1982) ("As an inseparable element of the constitutional system of checks and balances, and as a guarantee of judicial impartiality, Art. III both defines the power and protects the independence of the Judicial Branch.").

207. See SEC. & EXCH. COMM'N, *SEC Announces Enforcement Results for FY 2015* (Oct. 22, 2015), <https://www.sec.gov/news/pressrelease/2015-245.html> [<https://perma.cc/YX3X-5G5D>] ("Of the 807 enforcement actions filed in fiscal year 2015, a record 507 were independent actions for violations of the federal securities laws and 300 were either actions against issuers who were delinquent in making required filings with the SEC or were administrative proceedings seeking bars against individuals based on criminal convictions, civil injunctions, or other orders.").

may be inflated, due to the way they are compiled.<sup>208</sup> This study noted that such irregularities include counting derivative “follow-on” actions in the total number of enforcement actions,<sup>209</sup> joining multiple defendants in an action, and filing separate actions and bringing dual enforcement actions,<sup>210</sup> as the SEC may bring an enforcement action against a single defendant in both an administrative proceeding and in district court at the same time, depending upon the types of relief sought.<sup>211</sup> These irregularities make it difficult to determine a true count of the SEC’s enforcement activity based on their reported statistics.<sup>212</sup> To be fair, as the study also notes, it appears that in reporting their 2015 enforcement statistics, the SEC attempted to take this issue into account by separating “independent actions” and secondary-type actions from their total number of enforcement actions.<sup>213</sup> While this study raises issues regarding the true volume of enforcement actions filed by the SEC, the federal court system remains backlogged, and an increased caseload could be problematic.<sup>214</sup>

What is perhaps a more pressing concern for this seemingly-simple solution is the nature of the proceedings brought via administrative actions. Many enforcement actions brought by the SEC are for strict-liability offenses like delinquent filings for registered companies or contempt proceedings for violating previous orders.<sup>215</sup> Many of these delinquent filings “are ordinarily decided by default” because they are filed against shell companies that “fail to respond to the SEC’s order instituting proceedings.”<sup>216</sup> Additionally, many administrative enforcement proceedings have already been settled when filed, and the purpose of the filing was

208. See Velikonja, *supra* note 89, at 977 (arguing SEC’s enforcement statistics are inflated due to various irregularities and actual number of unique enforcement actions pursued may be lower than reported).

209. See *id.* at 935 (noting that many reported actions are “follow-on” actions, or actions that are “*derivative*” they are ordinarily based on an injunction that the SEC imposed in a primary enforcement action against the same offender based on the same set of facts”).

210. See *id.* at 934 (“[T]he SEC sometimes joins several defendants in a single enforcement action and at other times sues them individually. The SEC’s practices of filing separate or consolidated actions are not consistent over time and even between regional offices.” (footnote omitted)).

211. See *id.* at 934–35 (discussing various types of relief available in various forums, which can lead to SEC filing concurrent enforcement actions against same defendant arising from same conduct).

212. See *id.* at 938 (noting 755 enforcement actions reportedly filed in 2014 actually includes 507 unique actions after “follow-on and secondary enforcement actions are excluded”).

213. See *id.* at 935 n.194 (citing *SEC Announces Enforcement Results for FY 2015*, *supra* note 207).

214. See Joe Palazzolo, *In Federal Courts, the Civil Cases Pile up*, WALL ST. J. (Apr. 6, 2015, 2:09 PM), <http://www.wsj.com/articles/in-federal-courts-civil-cases-pile-up-1428343746> (discussing backlog in federal courts and noting some cases have been delayed for years).

215. See Velikonja, *supra* note 89, at 969 (discussing various enforcement actions, including strict liability enforcement actions, brought by SEC).

216. See *id.* at 942.

simply to obtain a monetary penalty for an already-litigated issue “now that the SEC can obtain monetary penalties . . . in administrative proceedings.”<sup>217</sup> If a large number of administrative enforcement actions are essentially uncontested, then it could be highly inefficient to require these matters to be filed in U.S. District Courts with already crowded dockets.

The overarching point that can be drawn from this information is that the SEC enforcement landscape is more complex than it may seem at first blush. There are multiple issues that would need to be considered before the facially-simple solution of using U.S. District Courts could be implemented. Given these complexities, if a wholesale move to U.S. District Courts were made, the cure could be worse than the disease.

There is, however, another proposal for using existing U.S. District Courts that could ameliorate many of these problems. The Due Process Restoration Act of 2015 introduced by Rep. Scott Garrett would give defendants in SEC-enforcement proceedings essentially the right to litigate the action in federal court.<sup>218</sup> The mechanics of this process are that if the SEC brings an administrative proceeding in which a cease-and-desist order and penalty could result, the defendant has the right to “require the [SEC] to terminate the proceeding.”<sup>219</sup> This right must be exercised within twenty days of the defendant’s “receiving notice of such proceeding.”<sup>220</sup> If the defendant exercises this right, the SEC would then have the right to bring a civil action “for the same remedy that might be imposed” in the administrative proceeding.<sup>221</sup> The bill also raises the standard of proof in SEC administrative proceedings to that of “clear and convincing evidence.”<sup>222</sup>

This bill is a more nuanced approach than simply requiring all enforcement actions to be filed in U.S. District Courts, but it still has its problems. It would address the issue of default and other essentially non-contested actions because parties that have already been previously found liable for the conduct at issue or are otherwise not planning to contest the SEC’s penalty presumably would have no incentive to force the SEC to file its actions in federal court. However, the problem previously identified would remain—when defendants exercise their right to require the SEC to file a civil action in federal court, more cases would be added to crowded federal dockets. While this would resolve the due process issue, it might not be optimal from a regulatory standpoint because cases in crowded federal courts may last for years.<sup>223</sup> While we are strong advocates of due process and a more literal application of Article III, that does

---

217. *See id.* at 966–67 (noting that in 2013 and 2014 “nearly three-quarters of [issuer reporting actions filed in administrative proceedings] were settled”).

218. *See* H.R. 3798, 114th Cong. § 2 (2015).

219. *See id.* § 2(a).

220. *See id.*

221. *See id.* § 2(b).

222. *See id.* § 2(c).

223. *See* Palazzolo, *supra* note 214.

not mean the SEC does not serve a valuable enforcement purpose and needs the ability to police our financial markets efficiently within the constitutional strictures of Article III. Thus, we submit that merely requiring the SEC to file more or all actions in U.S. District Courts is not the optimal solution to this problem. Fortunately, our Constitution is quite flexible and allows for other creative methods for addressing this problem.

B. *Create One or More Article III Trial Courts of Specialty Jurisdiction*

Our preferred alternative to the SEC's system of in-house enforcement actions is the creation of one or more Article III trial courts of specialty jurisdiction.<sup>224</sup> Congress clearly has such authority under Article III and has exercised it.<sup>225</sup> Such courts would have the power to hear cases arising only under federal securities laws. As such, these would be courts of limited jurisdiction. Like the judges and justices of all Article III courts, judges of these securities courts would enjoy Article III's tenure and salary protections.

For several reasons, moving federal securities cases exclusively to Article III courts makes sense. First, such a change would solve any separation of powers issues the current system creates. Though the current U.S. administrative state is firmly established and its system of administrative adjudication has been repeatedly upheld by the Supreme Court,<sup>226</sup> some still object to the exercise of judicial power outside of the judicial branch. Moving all securities-based cases to the judicial branch dispenses with such concerns.

A second reason for creating specialty courts for federal securities cases, and a natural follow-up to the first, is that clear separation of powers lends itself to greater judicial independence. No longer would the adjudicators be employees of the SEC, thus removing a significant concern about judicial bias. Lifetime tenure and salary protection would largely eliminate any actual, potential, or perceived pressure to side with the SEC. While it is true that bias toward the SEC could still be present for a particular judge—based on, for example, his or her past employment and/or ideology—such bias would not be present simply due to the way the system is structured currently, with ALJs employed by the very agency that brings enforcement actions before them and hears appeals of their decisions.

---

224. For ease of reading, the authors will refer in this Section to “courts.” Though the Section outlines a plan for creating a single court of specialty jurisdiction, the authors use “courts” to refer to both the single- and multiple-court options.

225. *See* U.S. CONST. art. III, § 1 (stating that Congress may “from time to time ordain and establish” inferior courts); *see also, e.g.*, 28 U.S.C. § 251 (2012) (creating Article III court of specialty jurisdiction U.S. Court of International Trade).

226. *See, e.g.*, *Williams v. United States*, 289 U.S. 553, 566 (1933) (noting judicial power has been exercised validly outside of Article III from very early period of American history).

A third justification for federal securities courts involves the volume and nature of securities cases. A system of trial courts devoted exclusively to an area of law that produces so many cases—cases that are often highly technical and complex—would lead to greater fairness, as well as greater procedural efficiency and consistency. Defendants facing suits in securities courts would know their cases are being heard by judges who specialize in the subject matter and have tenure and salary protection. Moreover, specialty courts operating under the same rules of evidence and procedure would lead to much greater procedural certainty for litigants. The issues surrounding differing rules of evidence and procedure highlighted above would be solved, and defendants would come closer to being on the same playing field. This arrangement is certainly preferable to the current system, where defendants are given fewer protections in the SEC's tribunal system than in federal court and some defendants face action in federal court, while others face action within the SEC.<sup>227</sup> Given the flexibility that the Constitution allows Congress in creating inferior courts, there are numerous ways to structure such courts.

#### 1. *Creation of a Single-Location, Specialty-Jurisdiction Trial Court*

One option is to create a single federal trial court devoted exclusively to all federal securities cases, meaning both enforcement actions brought by the SEC and actions between private litigants under the securities laws. A blueprint for such a court exists in the U.S. Court of International Trade (USCIT).<sup>228</sup> Formerly the U.S. Customs Court, the USCIT was created by Congress via the Customs Court Act of 1980.<sup>229</sup> As a specialized trial court created pursuant to Article III, the USCIT's judges are appointed by the President and confirmed by the Senate, and they enjoy tenure and salary protection.<sup>230</sup> The court is composed of nine judges and is located in New York City, and appeals from decisions of the USCIT are heard by the U.S. Court of Appeals for the Federal Circuit, with any subsequent appeals heard by the Supreme Court.<sup>231</sup> Thus, as the term “specialty trial court” suggests, the court functions like a U.S. District Court, but only for certain types of claims involving international trade.<sup>232</sup>

227. See Michael Dvorak, Note, *SEC Administrative Proceedings and Equal Protection “Class of One” Challenges: Evaluating Concerns About SEC Forum Choices*, 2015 COLUM. BUS. L. REV. 1195, 1200–10 (discussing recent equal protection challenges made against SEC based upon seemingly “arbitrary” decisions regarding which cases are brought before administrative proceedings and which are brought in federal court).

228. See U.S. CT. OF INT'L TRADE, *About the Court*, <http://www.cit.uscourts.gov/AboutTheCourt.html> [<https://perma.cc/65Y4-DH24>] (last visited Jan. 21, 2017).

229. See Pub. L. No. 96-417, 94 Stat. 1727 (1980).

230. See 28 U.S.C. §§ 251–252 (2012).

231. See *About the Court*, *supra* note 228.

232. See Lynn S. Baker & Michael E. Roll, *Securing Judicial Review in the United States Court of International Trade: Has Conoco, Inc. v. United States Broadened the*



If created as a single-location court, this Article proposes naming the court the U.S. Securities Court (USSC) and that the court be sited in either New York City or Washington, D.C., with a set number of judges, including a chief judge.<sup>233</sup> As is the norm for cases before the USCIT, cases before the USSC would be heard by a single judge.<sup>234</sup> Decisions of the USSC would be appealable to the U.S. Court of Appeals for the Federal Circuit and, subsequently, to the Supreme Court. Benefits of siting the USSC in a single location include the logistical efficiencies and financial savings that would come with a small number of judges in a single location, versus many more judges spread throughout the country.

Of course, there are also costs associated with a single court in one geographical location. The SEC's cases involve actions against defendants from all over the country and the world, so litigating enforcement actions in a single location could be burdensome to some litigants. However, this burden is no higher than that currently imposed by administrative proceedings. The SEC Office of Administrative Law Judges is currently located in Washington, D.C.<sup>235</sup> However, when it conducts hearings, it has the authority to hold them in locations convenient for the parties and witnesses involved.<sup>236</sup> Because the USCIT has a single location, it has similar authority for judges to hold trials in other locations more convenient to the litigants.<sup>237</sup> With modern motions practice, communication technology to aid in handling pre-trial hearings, and the ability of the judges to hold trials in convenient locations across the United States when neces-

---

*Jurisdictional Boundaries?*, 18 FORDHAM INT'L L.J. 726, 727–31 (1995) (discussing subject matter jurisdiction of USCIT over various international trade matters).

233. Like the USCIT, which is located in New York City, the proposed court could consist of nine judges, or some other number. Due to the volume of SEC actions against defendants, a higher number of judges would likely be needed. Regardless of the number of judges, the authors recommend that one of the judges serve as chief judge, as is the case with the USCIT.

234. See 28 U.S.C. § 254 (2012) (“Except as otherwise provided in section 255 of this title, the judicial power of the Court of International Trade with respect to any action, suit or proceeding shall be exercised by a single judge, who may preside alone and hold a regular or special session of court at the same time other sessions are held by other judges.”).

235. See SEC. & EXCH. COMM'N, INSTRUCTIONS FOR PRO SE RESPONDENTS 1, <https://www.sec.gov/alj/alj-instructions-for-respondents.pdf> [<https://perma.cc/375N-KPAE>] (last visited Mar. 26, 2017) (noting address for SEC's Office of Administrative Law Judges in Washington D.C. and requiring filings to be mailed there).

236. See 17 C.F.R. § 201.200 (c) (2016) (“The time and place for any hearing shall be fixed with due regard for the public interest and the convenience and necessity of the parties, other participants, or their representatives.”).

237. See 28 U.S.C. § 256(a) (2012) (“The chief judge may designate any judge or judges of the court to proceed, together with necessary assistants, to any port or to any place within the jurisdiction of the United States to preside at a trial or hearing at the port or place.”).

sary, a single-location Article III securities court should not be any more inconvenient than the current system.<sup>238</sup>

In fact, under this proposal, much of the current structural system could be maintained with relatively basic modifications to comply with Article III. As SEC ALJs are currently housed in Washington, D.C., that location could be maintained. The appointments process could be modified to require presidential appointment of the judges with advice and consent of the Senate<sup>239</sup> and with lifetime tenure and salary protection.<sup>240</sup> Thus, the accusations of bias against the SEC would be resolved, as the adjudicator would have gone through the same process as any other federal judge.

To resolve the procedural deficiencies alleged against the SEC, Congress could require the creation of, or create, new rules of procedure that would be used in these courts.<sup>241</sup> Thus, for example, for certain violations that tend to be non-contested, such as strict-liability filing offenses, lesser procedures that more closely match the current procedures could be crafted to allow for relatively expedited hearings. For more serious violations that require proof of *mens rea* or could result in steep monetary penalties or cease-and-desist orders, more robust procedures similar to, or the same as, those required in other federal courts could be used. As long as any such requirements meet relatively loose due process requirements, Congress is free to tailor these procedures to make the hearings of actions under the securities laws efficient yet fair.<sup>242</sup>

One potential impediment to efficiency in these courts would be the right to a jury trial. The Supreme Court has held that the Seventh Amendment's right to trial by jury applies differently in Article III courts than it does in non-Article III courts, such as administrative proceedings like the

---

238. It is also worth noting that a significant number of administrative proceedings never go to a hearing. The SEC reports that in fiscal year 2015, 207 initial decisions were made, but only 27 hearings were held. *See Office of Administrative Law Judges, supra* note 73. In 2013 and 2014, nearly 75% of unique issuer reporting administrative actions filed by the SEC were settled. *See Velikonja, supra* note 89, at 966–67. If a similar rate of settlement or disposition without trial continues to hold true, most enforcement actions would not require a hearing or trial, ameliorating any location burden. Of course, it could be possible that the rate of settlement was this high because parties wished to avoid going before an administrative proceeding where they felt they would not receive fair treatment, as opposed to a judicial trial.

239. *See* U.S. CONST. art. II, § 2, cl. 2.

240. *See id.* art. III, § 1.

241. *See generally* 28 U.S.C. §§ 1651–2113 (2012) (providing various rules of procedure for federal courts, some of which are mandatory and others which may be modified by Supreme Court with approval of Congress).

242. *See Morrissey v. Brewer*, 408 U.S. 471, 481 (1972) (“[D]ue process is flexible and calls for such procedural protections as the particular situation demands.”); *Bell v. Burson*, 402 U.S. 535, 540 (1971) (“A procedural rule that may satisfy due process in one context may not necessarily satisfy procedural due process in every case. Thus, procedures adequate to determine a welfare claim may not suffice to try a felony charge.” (citing *Goldberg v. Kelly*, 397 U.S. 254, 270–71 (1970); *Gideon v. Wainwright*, 372 U.S. 335 (1963))).

SEC's tribunals.<sup>243</sup> Under this line of reasoning, cases involving public rights that might require a jury trial if adjudicated in an Article III court do not require a jury trial if held in an administrative tribunal.<sup>244</sup> Among the type of claims that the Supreme Court has found require a jury trial in an Article III court, but not in an administrative proceeding, are those seeking civil monetary penalties.<sup>245</sup> Thus, though the SEC currently can pursue monetary penalties without a jury in an administrative setting, under our proposal to require such proceedings to be filed in federal court, a right to trial by jury would exist.<sup>246</sup> In other words, though Article I tribunals involving statutory violations leading to civil penalties can constitutionally be held without a jury, the creation of our proposed specialty-jurisdiction Article III court would come with the right to a jury for these same cases.

While this may seem a detriment to some, because a jury trial certainly would slow down some proceedings, it may come as a benefit of this Article's recommendation. A jury trial is an important protection for defendants. This Article submits, as other commentators have, that if the SEC is seeking civil penalties, it should be required to convince a jury of the liability of the defendant.<sup>247</sup> Any loss in efficiency due to a jury-trial requirement is more than made up for by the important rights jury trials provide defendants. Additionally, it is questionable how much an increase jury trials would impede enforcement efficiency, given that the large number of actions the SEC files that are either not contested or settled.<sup>248</sup>

Further, if a single-location, specialty-jurisdiction court is deemed too inconvenient to replace the current system, the court's jurisdiction could

---

243. See *Atlas Roofing Co., Inc. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 460–61 (1977) (“Thus, history and our cases support the proposition that the right to a jury trial turns not solely on the nature of the issue to be resolved but also on the forum in which it is to be resolved.”).

244. See *id.* at 455 (“[W]hen Congress creates new statutory ‘public rights,’ it may assign their adjudication to an administrative agency with which a jury trial would be incompatible, without violating the Seventh Amendment’s injunction that jury trial is to be ‘preserved’ in ‘suits at common law’ . . . . This is the case even if the Seventh Amendment would have required a jury where the adjudication of those rights is assigned instead to a federal court of law instead of an administrative agency.”).

245. See *id.* at 450 (noting Congress’ ability to create statutory obligations and provide for monetary penalties for violations in administrative proceedings). *But see Tull v. United States*, 481 U.S. 412, 420 (1987) (holding that Seventh Amendment requires jury trial when government seeks monetary penalties for violation of regulatory statute in federal court).

246. See *Tull*, 481 U.S. at 420.

247. See Suja A. Thomas & Mark Cuban, Op-Ed, *A Jury, Not the S.E.C.*, N.Y. TIMES (Oct. 16, 2015), [http://www.nytimes.com/2015/10/17/business/dealbook/a-jury-not-the-sec.html?\\_r=0](http://www.nytimes.com/2015/10/17/business/dealbook/a-jury-not-the-sec.html?_r=0) [https://perma.cc/JMR7-5FVR] (discussing challenges to SEC tribunals and noting “[m]any of the challenges, such as one brought by the private equity financier Lynn Tilton, focus on matters that do not go to the heart of the issue. The real issue is an individual’s right to a jury trial”).

248. See *supra* notes 216–17 and accompanying text.

be modified to allow more flexibility. For example, rather than granting exclusive jurisdiction, Congress could grant the court a level of jurisdiction more akin to concurrent jurisdiction, whereby the SEC must first file claims in the USSC, but the defendant could have the case transferred to a local U.S. District Court. This right of transfer could be structured as mandatory or upon the discretion of the judge. For private litigants bringing securities claims, the right could be given in the opposite direction: plaintiffs could be allowed to bring claims under the securities laws in U.S. District Courts but with the right of defendants to file a motion for transfer to the USSC. Because such jurisdictional arrangements would not remove a federal case from federal jurisdiction, but would simply allocate it to different federal courts, this structure would be well within Congress's Article I powers.<sup>249</sup>

## 2. *Creation of Multiple Specialty-Jurisdiction Trial Courts*

As another option, instead of creating a single-location court, the USSC could be situated among the federal districts, with a single securities court in each district, similar to U.S. Bankruptcy Courts.<sup>250</sup> Notably, U.S. Bankruptcy Courts are not Article III courts because bankruptcy judges do not have lifetime tenure or salary protection.<sup>251</sup> Under this Article's proposal, these specialty-jurisdiction trial courts would follow Article III's appointment, tenure, and salary-protection requirements.<sup>252</sup> Benefits of placing the courts throughout the country, as opposed to in a single location, include convenience of the parties—chiefly defendants but also any witnesses for either party—to litigation. Having a securities court in each federal district would also lessen the workload of the securities judges nationwide. As with the previous recommendation of a single-location, specialty-jurisdiction court, Congress could tailor procedures and jurisdictional requirements to make these courts efficient yet fair.<sup>253</sup>

While there are some convenience-based benefits to this option, the costs and logistics associated with creating a securities trial court for each of the nation's ninety-four federal districts<sup>254</sup> are certainly not preferable compared to the costs and logistics of creating a single-location securities

249. See Calabresi & Rhodes, *supra* note 56, at 1160–64 (discussing both broad and narrow theories of Congressional power over Article III courts, but under either theory Congress is allowed to create inferior court and allocate jurisdiction over different disputes amongst them).

250. See FED. JUD. CTR., *Bankruptcy Courts*, [http://www.fjc.gov/history/home.nsf/page/courts\\_special\\_bank.html](http://www.fjc.gov/history/home.nsf/page/courts_special_bank.html) [https://perma.cc/3HJC-PFP6] (last visited Jan. 21, 2017) (discussing structure of U.S. Bankruptcy Courts).

251. See 28 U.S.C. § 152(a) (2012) (providing that bankruptcy judges serve terms of fourteen years and are “judicial officers” of district courts in which they serve).

252. See U.S. CONST. art. III, § 1.

253. See *supra* Part III.B.1.

254. See 28 U.S.C. § 133(a) (2012) (setting forth judicial districts of U.S. court system).

court, or creating a securities trial court for each of the nation's twelve federal circuits (excluding the Federal Circuit).<sup>255</sup> By spreading all securities cases among ninety-four judges, the burden on each judge with respect to the judge's caseload would certainly be diminished. However, it is doubtful that there would be a sufficient amount of securities litigation to justify an Article III securities judge in each judicial district. Even if the judges are allocated to each appellate circuit, some circuits cover a geographical area that does not lend itself to significant securities litigation.<sup>256</sup> Thus, as an alternative, an Article III securities judge could be placed in the judicial districts in which the SEC headquarters and regional offices reside.<sup>257</sup> Counting the SEC headquarters in Washington, D.C., this would bring the total number of judgeships to twelve and would ensure that the securities judges are housed near the enforcement arms of the SEC.<sup>258</sup> As under this Article's proposal for a single-location court, cases would be heard by a single judge.

Appeals would be filed with the geographically appropriate U.S. Court of Appeals, meaning the circuit in which the trial court is located. Alternatively, appeals could be directed to the U.S. Court of Appeals for the Federal Circuit, as are appeals from the USCIT.<sup>259</sup> For practical reasons, notably the volume of federal securities cases and the convenience of defendants, the authors prefer the former option.

### 3. *Specialty-Jurisdiction Trial Courts with Broad Financial Jurisdiction*

One potential argument against the practicality of specialty-jurisdiction securities courts, whether employing a single-location court or courts throughout the country, is that while the volume of securities litigation in the U.S. is significant, it is not sufficient to justify the creation of its own courts. This Article argues that replacing only the existing ALJ structure with Article III-compliant judges and more robust processes would not greatly increase the cost of maintaining the current ALJ office. Thus, this objection should not serve as a bar to the first recommendation. It is a more compelling objection to the creation of multiple specialty-jurisdiction courts. Nevertheless, anticipating this objection, a novel way to address this issue is to allow the specialty courts proposed to have jurisdiction over a much larger swath of federal financial regulation.

---

255. See 28 U.S.C. § 41 (2012) (setting forth judicial circuits of U.S. court system).

256. See *id.* For example, the Eight Circuit covers "Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota." See *id.* While there is certainly some securities litigation in this circuit, it pales in comparison to the Second Circuit, which contains New York, a hub of international finance.

257. See SEC. & EXCH. COMM'N, *SEC Addresses: Headquarters and Regional Offices*, <https://www.sec.gov/contact/addresses.htm> [<https://perma.cc/PJ8U-SE7E>] (last visited Jan. 21, 2017) (setting forth SEC regional offices).

258. See *id.*

259. See *About the Court*, *supra* note 228.

In the wake of the sub-prime lending crisis, the federal financial regulatory focus has shifted to “addressing systemic risk,” also referred to as a “macroprudential” regulatory focus.<sup>260</sup> Former Federal Reserve Chairman Ben Bernanke has broadly defined systemic risk as “developments that threaten the stability of the financial system as a whole and consequently the broader economy, not just that of one or two institutions.”<sup>261</sup> This shift occurred due to the lesson learned in the sub-prime crisis: that seemingly unrelated risk taking or regulatory failures can threaten financial stability because of the highly interconnected nature of our markets and financial institutions.<sup>262</sup> To address this systemic risk, Dodd-Frank created the Financial Stability Oversight Council (FSOC) to bring together various federal financial regulatory agencies and coordinate their efforts to “constrain excessive risk in the financial system.”<sup>263</sup> The SEC is a member of the FSOC, along with the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission (CFTC), the Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), National Credit Union Administration (NCRUA), Office of the Comptroller of the Currency, the Treasury Department, and the Consumer Financial Protection Bureau (CFPB).<sup>264</sup> Because these agencies are required to coordinate their efforts to manage the stability of

260. See Miriam F. Weismann, Jason H. Peterson & Christopher A. Buscaglia, *The New Macroprudential Reform Paradigm: Can It Work?*, 16 U. PA. J. BUS. L. 1029, 1033 (2014) (citing Ben S. Bernanke, Chairman, Fed. Reserve Bank, Address Before the 47th Annual Conference on Bank Structure and Competition (May 5, 2011)) (discussing change in regulatory focus to macroprudential concerns after passage of Dodd-Frank Act).

261. See Corey Boles, *Bernanke Offers Broad Definition of Systemic Risk*, WALL ST. J. (Nov. 18, 2009, 12:23 PM), <http://blogs.wsj.com/economics/2009/11/18/bernanke-offers-broad-definition-of-systemic-risk>.

262. See Nellie Liang, *Systemic Risk Monitoring and Financial Stability*, 45 J. MONEY, CREDIT & BANKING 129, 130 (2013) (“The recent financial crisis demonstrates vividly that there are many channels through which seemingly small losses can become systemic and threaten financial stability. Systemic risk arises when shocks are amplified and inflict significant damage on the broader financial system and broader economy.”); Joseph E. Stiglitz, *Risk and Global Economic Architecture: Why Full Financial Integration May Be Undesirable*, 100 AM. ECON. REV. 388, 388 (2010) (noting that integration of financial markets has led to systemic risk and that “in the absence of appropriate government intervention, privately profitable transactions may lead to systemic risk”).

263. See U.S. DEP’T OF THE TREASURY, *Financial Stability Oversight Council: About FSOC*, <http://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx> [https://perma.cc/ESJ3-MJMD] (last visited Jan. 21, 2017) (“The Financial Stability Oversight Council has a clear statutory mandate that creates for the first time collective accountability for identifying risks and responding to emerging threats to financial stability. It is a collaborative body chaired by the Secretary of the Treasury that brings together the expertise of the federal financial regulators, an independent insurance expert appointed by the President, and state regulators.”).

264. See U.S. DEP’T OF THE TREASURY, *Financial Stability Oversight Council: FSOC Member Agencies*, <https://www.treasury.gov/initiatives/fsoc/about/Pages/FSOC-Member-Agencies.aspx> [https://perma.cc/K7D5-E9FN] (last visited Jan. 21, 2017).

our financial system and guard against systemic risk, it would be a natural fit for the specialty-jurisdiction courts proposed in this Article to be given jurisdiction to hear disputes arising from the actions of all of these agencies.

Not every one of these agencies administers a statutory scheme that requires filing civil enforcement actions or provides for civil suits to be brought by private parties. But for those that do, the jurisdiction of the specialty-jurisdiction court proposed could be expanded to include their respective actions in the same way the authors recommend with respect to the SEC. This recommendation would provide litigants under those regulatory schemes with an efficient but fair court to hear these disputes, rather than being forced into administrative proceedings. Additionally, the judges in these courts would have or develop expertise in financial matters and the implementation of these statutes and, thus, would presumably be able to adjudicate complex financial disputes better.

Such a court system would resolve the potential objection previously raised that a court that heard only securities disputes would not have a sufficient caseload to justify its existence, and it would also have other benefits. First, it would allow those regulated by all of the above-mentioned agencies to have the constitutional protection of the Article III judicial process proposed in this Article, not just those regulated by the SEC. Additionally, because these agencies are called to coordinate their efforts under the FSOC, a subject-matter-specific, specialty-jurisdiction court might aid them in doing so. The expert judges of these specialty courts would likely give better rulings in complex financial cases, and if the same appellate court hears all appeals, the potential for conflicting precedent is lessened. Finally, because systemic risk and financial-system integrity are increasingly important regulatory issues, such a court system would signal to the financial markets and the public a commitment to both rigorous regulation and fair procedures for the regulated.

Each of these approaches rectifies the problem of the SEC's administrative tribunals and provides an independent Article III judiciary in an area of law of national importance. For practical reasons, the most reasonable approach is a single-location Article III court, located in Washington, D.C., or New York City. As long as this court is staffed with a sufficient number of judges with the ability to travel and hold court in other locations for purposes of convenience, this approach would likely be the most cost-effective way to replace the SEC's ALJs with Article III judges. Whether given jurisdiction over only securities law disputes or over the expanded range of FSOC suits, this court would serve a critically important function as a properly established federal court with financial expertise. This proposal addresses the constitutional concerns currently being raised in SEC administrative tribunals and aids in the development and protection of our system of financial regulation.<sup>265</sup>

---

265. *See supra* Part II.

CONCLUSION

For decades, the SEC has pursued cases against defendants via both federal courts and in-house enforcement proceedings. Over time, the SEC's authority to employ the latter has expanded, and it significantly increased pursuant to new powers granted to the SEC by Dodd-Frank. As the SEC has increased its use of enforcement actions in SEC tribunals, opposition to tribunals has grown louder, as have calls for reform.

We believe the time for wholesale reform has come. The allegations being levied against the SEC, whether always accurate are not, are merely proof of the importance of an independent judiciary, as enshrined in our Constitution. The SEC's recent success rate in tribunals, relative to its win rate in federal courts, is not the problem. Rather, it is a symptom of the problem. The real problem is the very use of tribunals for cases that should be heard solely by Article III courts, particularly when such tribunals do not provide defendants the important due process protections provided by federal courts. However, simply adding a fuller range of procedural protections to tribunal hearings does not address the root problem—a judicial process that does not belong outside of the federal judiciary in the first place.

Our nation's Founding Fathers created a country whose government was built on the notion that the separate branches of government should possess certain powers and that those powers should be protected against encroachment by the other branches. Coincident with this notion, our Founders believed in an independent judicial branch that possessed complete judicial power, free to rule on matters of federal law without unlawful incursions by any other branch of government. Nevertheless, over time, Congress has often placed certain judicial powers outside of the judicial branch and into the hands of federal administrative agencies. The Supreme Court has willingly played along, frequently putting its imprimatur on various non-Article III tribunals' possession of such power. As a result, the federal administrative state's possession of judicial functions is now firmly entrenched in our system of government.

However, although our country has done something for a long period of time, this does not mean it is legitimate or wise to do so. While the Supreme Court has routinely approved of transfers of judicial powers, such transfers are not necessarily right or binding on Congress in structuring administrative agencies. In the view of the authors of this Article, the recent accusations against the SEC exemplify this encroachment on judicial power reaching a boiling point, and it is time to reverse course. The proposals discussed in this Article provide for doing so. In particular, the proposal for a single-location Article III securities or FSOC-based court is a sensible, cost-effective way to restore integrity and fairness to a fundamentally broken judicial process.