

Litigation Alert

August 14, 2015

If you read one thing...

- Judge Berman's decision provides a significant potential defense to companies and individuals targeted in SEC investigations
- SEC's increased use of administrative proceedings, a power partially granted by Dodd-Frank, are subject to only limited judicial review



SDNY Judge Berman Enjoins SEC Administrative Proceeding as "Likely Unconstitutional"

In recent years, taking advantage of expanded jurisdictional provisions in Dodd-Frank, the U.S. Securities and Exchange Commission (SEC) has brought an increasing number of enforcement actions, including complex matters with difficult factual and legal issues, through administrative proceedings, rather than in federal court as has traditionally been the case. As the *Wall Street Journal* observed in [June](#) and [August](#) of 2015, this practice has been widely criticized, but the SEC has insisted that it maintains legal authority to choose the forum in which to bring its cases and has [published](#) non-binding criteria to guide its decisions in this regard. On August 12, 2015, U.S. District Judge Richard M. Berman, of the Southern District of New York, dealt a setback to the SEC by [preliminarily enjoining](#) its administrative proceeding against former Standard & Poor's Ratings Services executive Barbara Duka. Judge Berman found that the SEC's procedure in hiring administrative law judges (ALJ) for such administrative proceedings was "likely unconstitutional," because SEC staff—and not the SEC commissioners—hire ALJs. Judge Berman found that such a practice is likely to be in violation of the Appointments Clause and insulates the SEC's administrative law judges from removal, even by the president of the United States. Judge Berman joins Judge Leigh Martin May of the Northern District of Georgia, who recently halted two other SEC administrative proceedings on the same grounds.

The SEC favors administrative proceedings because of their increased speed and efficiency. However, such proceedings leave respondents at a disadvantage in a number of important respects:

- They take place on an expedited schedule (which tends to favor the SEC given its ability to conduct extensive investigations before initiating enforcement proceedings).
- They are subject to only limited judicial review, as described below.
- They involve only limited discovery (with no provision for either depositions or interrogatories).

- They permit the introduction of hearsay and other evidence that would not be admissible in federal court under the Federal Rules of Evidence.

Of particular importance is the fact that the SEC's administrative proceedings are subject to only limited judicial review. While they are ultimately appealable to federal courts of appeals, decisions in administrative proceedings are subject to deference, whereas federal district court decisions on matters of law are subject to de novo review. Thus, the SEC's administrative law judges, who are paid by the SEC and not subject to presidential appointment (or removal) or Senate confirmation, may interpret questions of law in a manner that is (or is perceived to be) favorable to the SEC and its Division of Enforcement. Indeed, Judge Jed Rakoff of the Southern District of New York has [cautioned](#) that the SEC's use of administrative proceedings could cause the SEC to "become, in effect, a law unto itself."¹

It remains unclear how Judge Berman's injunction against the SEC will affect SEC's use of administrative proceedings. Judge Berman suggested that the SEC could resolve the constitutional issue by altering its hiring practice for ALJs and having the SEC's commissioners directly appoint them. For now, the SEC has declined to adjust its hiring practice, and companies and individuals alike should be aware of this potentially significant defense to the SEC's exercise of its enforcement authority through administrative action. Akin Gump continues to follow litigation of this issue and encourages you to contact us should you have any questions about Judge Berman's Order or SEC enforcement more generally.

¹ Jed S. Rakoff, *Is the S.E.C. Becoming a Law Unto Itself?*, Address Before the PLI Securities Regulation Institute (Nov. 5, 2014) (transcript available at [here](#)).

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