

SEC Enforcement Division Issues Guidance on Venue Selection

Respondents in SEC enforcement actions increasingly will litigate a wide array of matters in administrative proceedings, rather than having their day in federal district court.

In the wake of significant public attention — including a fair amount of criticism — regarding the Securities and Exchange Commission’s increased use of administrative proceedings to enforce the federal securities laws,¹ the SEC’s Division of Enforcement recently issued written guidance setting forth the considerations that generally inform its forum selection for enforcement actions. The [Division of Enforcement Approach to Forum Selection in Contested Actions](#) prescribes four broad factors that the Division may consider in deciding whether to seek to enforce the securities laws through a civil action in federal district court or an administrative proceeding before an SEC Administrative Law Judge (ALJ).²

The Division’s Guidance does not appear to constrain meaningfully the scope of the Division’s discretion in seeking — or the full Commission’s prerogative in deciding upon — a particular venue. Instead, it appears an attempt to answer critics and support the SEC’s view that administrative proceedings are an appropriate forum for a wide range of cases that historically played out in federal court, with the prospect of the SEC using these proceedings to shape securities law in decisions potentially subject only to deferential judicial review. The Guidance also reinforces the need for those involved in an SEC investigation to understand clearly the SEC’s distinctive administrative process and be prepared for the possibility of litigating before an ALJ, rather than a federal district judge.

The Division’s Increasing Use of Administrative Enforcement Proceedings

Prior to 2010, the Commission could obtain monetary penalties administratively only against so-called “registered” entities — primarily broker-dealers and investment advisers.³ The Dodd-Frank Act broadly expanded the SEC’s authority to utilize administrative proceedings.⁴ Whereas the SEC was previously required to bring enforcement actions seeking most penalties against any non-registered entities or individuals in federal district court, it may now initiate most such cases before an ALJ.⁵ The Division staff’s decision on where to proceed is, as a practical matter, not subject to attack. Although “the Division’s recommendations are in all cases subject to review and approval by the Commission,”⁶ experience demonstrates that the Commission inevitably defers to the Division’s recommendation. To date, collateral attacks on forum selection have not been successful.⁷

In the nearly five years since Dodd-Frank was enacted, as the Division’s Director, Andrew Ceresney, acknowledged recently, the SEC’s use of administrative proceedings has steadily increased.⁸ In 2014, for example, the SEC instituted more than 610 administrative proceedings — nearly double the number of administrative actions filed in 2005.⁹ And so far in 2015, the SEC has filed almost 40 percent of its litigated cases in administrative proceedings.¹⁰ Indeed, this increasing preference has led senior officials

in the Division to refer to administrative actions as “the new normal.”¹¹ And this new normal has often yielded successful results for the Division. In 2014, for example, the Division won all six of the administrative cases it litigated to verdict, but lost seven of its 18 federal court trials.¹² Between October 2010 and March 2015, the Division won a reported 90 percent of the cases pursued through administrative proceedings, as compared to just 69 percent in federal court cases during the same period.¹³

The Division’s apparent growing preference for an administrative forum has not gone without criticism. Observing the SEC’s arguable “overuse” of the administrative mechanism, some commentators have condemned the Division’s exercise of a “home court advantage” as potentially unfair,¹⁴ and even as constitutionally suspect.¹⁵ Indeed, Mary Jo White, the SEC’s current Chair, has herself recognized jury trials “in open court” as vital to both “the law and public accountability.”¹⁶ Despite these challenges, Ceresney has defended the SEC’s “use of the administrative forum” as “eminently proper, appropriate, and fair to respondents.”¹⁷

SEC Administrative Proceedings versus Federal District Court Litigation

The SEC’s forum selection for enforcement actions is not a minor matter of procedure, but rather can profoundly shape the adjudicatory process, from beginning to end.¹⁸

First, the trial-level adjudicator and path for appeal both differ. In the administrative context, an SEC ALJ — as a formal matter, an employee of the SEC’s Office of Administrative Law Judges who hears exclusively SEC-related matters — is assigned to preside over all actions initiated through an Order Instituting Proceedings, or OIP. The ALJ resolves all disputes, including ultimately making findings of fact and reaching conclusions of law. The ALJ’s initial decision is subject to review in the first instance by the Commission — ordinarily the same commissioners who authorized bringing the enforcement action. Only thereafter, having exhausted its administrative recourse, may a respondent appeal to an Article III court of appeals at the third level of review. And when that appellate review occurs, the Article III court may have to afford deference to at least some important aspects of the Commission’s order.¹⁹

The administrative forum also presents important evidentiary and procedural distinctions. All aspects of administrative proceedings are governed by the SEC’s Rules of Practice.²⁰ The Federal Rules of Civil Procedure do not apply. Accordingly, while the SEC has so-called “Brady” and “Jencks” obligations to turn over certain information (including exculpatory evidence) in administrative proceedings, discovery is often limited. For example, depositions, interrogatories, and requests for admissions ordinarily are not available. Further, while parties can potentially advance dispositive motions in advance of an administrative trial, in practice parties often lack an opportunity to have a case resolved in a manner comparable to summary judgment. Nor is there any right to trial by jury — a right which the current head of the SEC has extolled as “creat[ing] accountability for both defendants and the government.”²¹ And the Federal Rules of Evidence are inapplicable. These important distinctions fundamentally alter the defense of an enforcement action.

Timing also differs. Administrative actions typically proceed more expediently. Under the SEC’s Rules of Practice, an ALJ’s initial decision must issue within 300 days after service of the OIP — or less in some instances.²² In contrast to most district court cases, therefore, an administrative proceeding before an SEC ALJ may proceed from inception to trial within a matter of mere months.

In short, a party subject to an enforcement action before an ALJ instead of a federal district judge operates in a different system, governed by different individuals and rules, and on a different schedule.

Recent Division Guidance on Forum Selection

Since the passage of Dodd-Frank in 2010, the Division has enjoyed wide discretion in the forum selection process, subject to Commission approval. Written guidance issued last week sheds some light on *how* the Division has exercised that discretion, but identifies very few limitations on such discretion.

As an overarching principle, the Division favors the forum that “will best utilize the Commission’s limited resources” to “protect investors and the integrity of the markets through strong, effective, and fair enforcement of the federal securities laws.”²³ Although not directed by any “rigid formula,” the Division has explained that this determination implicates multiple considerations, which may apply and/or be weighted differently given the particular facts of a specific case. As Ceresney noted after the Guidance was released, the following factors are “not exhaustive”; “the staff may consider some or all of” them in a certain instance, and in “some cases, a single factor may be important enough to carry the day.”²⁴

- **“The availability of the desired claims, legal theories, and forms of relief in each forum”** – The securities laws may dictate the forum or available remedies for certain causes of action. For example, the Division’s Guidance notes that charges of failure to supervise or causing another person’s violation generally can be litigated only in an administrative tribunal, whereas “controlling person” liability can be pursued only in district court. And only district courts can typically issue emergency relief — for example, temporary restraining orders. To the extent the Division wishes to pursue certain claims or remedies, its choice of forum may be prescribed by law.
- **“Whether any charged party is a registered entity or an individual associated with a registered entity”** – The Division’s Guidance also submits that registered entities and associated persons are, by definition, subject to SEC oversight and discipline through the administrative system. Further, certain remedies related to these parties may be available only via administrative proceedings. Finally, the Division contends that SEC ALJs deal with the issues affecting registered entities and associated persons more frequently than do the federal courts and thus ALJ are more familiar with the framework and common questions that arise. In that respect, the Division may conclude that the involvement of registered entities or associated individuals weighs in favor of an administrative action.
- **“The cost-, resource-, and time-effectiveness of litigation in each forum”** – The Division generally will prefer the most “efficient and effective” forum. As an initial matter, *speed* is an important consideration. As noted, actions before an ALJ often proceed more quickly than district court cases. Further, the ability to *resolve all issues in a single proceeding* may support a particular forum, depending on the circumstances. The *efficiencies* of one venue may also outweigh those of another, such as the ability to seek summary judgment in federal district court. Finally, according to the Division, the *availability of, or limitations on, discovery* may be a consideration in determining the appropriate forum.
- **“Fair, consistent, and effective resolution of securities law issues and matters”** – Here again, the Division takes the position that SEC ALJs may possess an expertise of not only the relevant law, but also of the implicated industries. Accordingly, the Division indicates that the subject-matter expertise of these individuals and of the SEC itself, on appellate review of ALJ decisions, is often considered in determining whether to file an action at the SEC or in federal district court. However, the Division’s Guidance notes that if state law or other areas of federal law are applicable, or if similar claims against the same parties have been filed in federal court, this factor may weigh in favor of pursuing an enforcement action in district court.

Conclusion

Several aspects of — and key takeaways from — the Division’s recent Guidance must be considered for practitioners and any individuals or entities potentially subject to SEC oversight:

- First, although the Guidance offers some insight into the factors informing the SEC’s forum selection decision-making, it likewise basically affirms the SEC’s view of the venue-selection process as subject to rather broad discretion without meaningful limitations.
- Second, notwithstanding their breadth and flexibility, the factors enumerated in the Guidance may provide potential respondents in SEC enforcement actions with at least some concrete grounds to advocate, during the Wells process,²⁵ for selecting one forum over another.
- Third, and most importantly, the Guidance confirms that the Division views administrative proceedings before ALJs as potentially appropriate for an exceptionally wide range of matters. As a procedural matter, while legal and public challenges to the SEC’s expanded use of its administrative process continue to play out, those across the table from the Division should expect continued, significant use of administrative proceedings and must be prepared to defend enforcement actions in that distinct forum. As a substantive matter, the SEC’s increased use of administrative proceedings will potentially enable the SEC to shape federal securities law in an ever-wider array of matters, including — as the Guidance notes — cases that “raise unsettled and complex legal issues.”²⁶

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Endnotes

- ¹ See, e.g., Peter J. Henning, S.E.C. Faces Challenges Over the Constitutionality of Some of Its Court Proceedings, *New York Times* (Jan. 27, 2015), available at http://dealbook.nytimes.com/2015/01/27/s-e-c-faces-challenges-over-the-constitutionality-of-some-of-its-court-proceedings/?_r=0; Stephen Joyce, Rakoff, Practitioners Question SEC Practice Of Sending More Enforcement Cases to ALJs, *Bloomberg BNA* (Mar. 6, 2015), available at <http://www.bna.com/rakoff-practitioners-question-n17179923714>.
- ² SEC Enforcement Div., Division of Enforcement Approach to Forum Selection in Contested Actions, available at <http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf> [hereinafter "SEC Forum Selection Guidance"]. While the Division actually issued the Guidance, the SEC's Chairperson and Commissioners ultimately determine the forum for an enforcement action.
- ³ See Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931.
- ⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
- ⁵ *Id.* § 929P.
- ⁶ Andrew Ceresney, Director, SEC Division of Enforcement, Keynote Speech at New York City Bar Fourth Annual White Collar Institute (May 12, 2015) [hereinafter "Ceresney May 12, 2015 Speech"], available at http://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html?hootPostID=e4a6f98f9c30c062a9d741c5b3075fd5#_ftnref19.
- ⁷ See, e.g., *Chau v. SEC*, No. 14-CV-1903 LAK, 2014 WL 6984236, at *13-14 (S.D.N.Y. Dec. 11, 2014) (addressing constitutional challenges to SEC ALJ proceedings, and concluding that, despite "legitimate" concerns about "the growth of administrative adjudication," the decision between the "two tracks on which [the SEC] may litigate certain cases ... is a matter of enforcement policy squarely within the SEC's province"); *Bebo v. SEC*, No. 15-C-3, 2015 WL 905349, at *4 (E.D. Wis. Mar. 3, 2015) (same); *In the Matter of Charles L. Hill, Jr.*, SEC Rel. No. 2675, at 2 (May 14, 2015).
- ⁸ *Id.*
- ⁹ See Ryan Jones, *The Fight over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, *Southern Methodist University Law Review* (forthcoming), at 2 n.8, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2589703.
- ¹⁰ Ceresney May 12, 2015 Speech.

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- ¹¹ Jean Eaglesham, *SEC Steering More Trials to Judges It Appoints Unpublished Figures Show 'Win' Rate for Cases Heard by Administrative Law Judges*, Wall Street Journal (Oct. 21, 2014), available at <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590>.
- ¹² *Id.*
- ¹³ Aruna Viswanatha, *SEC Issues Guidance on Venue for Cases*, Wall Street Journal (May 8, 2015), available at <http://www.wsj.com/articles/sec-issues-guidance-on-venues-for-cases-1431126411>; see also Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, New York Times (Oct. 5, 2013), available at http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html?_r=0.
- ¹⁴ Thaya Knight, *ALJs and the Home Court Advantage*, Cato Institute (May 12, 2015), available at <http://www.cato.org/blog/aljs-home-court-advantage>.
- ¹⁵ See, e.g., Hon. Jed S. Rakoff, U.S. District Court for the Southern District of New York, Keynote Address at the PLI Securities Regulation Institute: Is the SEC Becoming a Law unto Itself? (Nov. 5, 2014), available at <http://assets.law360news.com/0593000/593644/Sec.Reg.Inst.final.pdf> (observing that, with respect to administrative proceedings, “the law in such cases would effectively be made, not by neutral federal courts, but by SEC administrative judges”); *Chau*, 2014 WL 6984236, at *13-14.
- ¹⁶ Mary Jo White, SEC Chair, *The Importance of Trials to the Law and Public Accountability*, Fifth Annual Judge Thomas A. Flannery Lecture (Nov. 14, 2013) [hereinafter, “White Nov. 14, 2013 Speech”], available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540374908>.
- ¹⁷ Andrew Ceresney, Director, SEC Division of Enforcement, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297>.
- ¹⁸ The Division has described these distinctions as “benefits to using the administrative forum that can lead [the Division] to file cases there.” *Id.*
- ¹⁹ Several members of the Supreme Court recently called into question the propriety of such deference where the relevant statute or regulation in an administrative proceeding potentially “has both criminal and civil applications.” *Whitman v. United States*, 135 S. Ct. 352, 353 (2014) (Scalia, J., concurring in denial of certiorari).
- ²⁰ 17 C.F.R. § 201.100.
- ²¹ White Nov. 14, 2013 Speech.
- ²² 17 C.F.R. § 201.360.
- ²³ SEC Forum Selection Guidance at 1.
- ²⁴ Ceresney May 12, 2015 Speech.
- ²⁵ The Wells process allows a person or entity under investigation to engage with the SEC — including through a written “Wells submission” — before the Commission decides whether to formally pursue an enforcement action. See 17 C.F.R. § 202.5(c). It thus the process provides an opportunity to affect the nature and scope of any enforcement action, and potentially to obviate the need for an enforcement action altogether.
- ²⁶ SEC Forum Selection Guidance at 3.