BEYOND *JARKESY*: RETHINKING THE ROLE OF ADMINISTRATIVE LAW JUDGES IN SEC ADMINISTRATIVE PROCEEDINGS

Mark T. Uyeda[*]

Jaime Marinaro[**]

---

[*] Commissioner, U.S. Securities and Exchange Commission (SEC or the "Commission").

[**] Counsel to Commissioner Mark T. Uyeda, SEC. The views expressed in this essay represent the individual views of the authors in their official capacities at the SEC. They do not necessarily reflect the views of the Commission, any other Commissioners, or the staff of the Commission. The authors wish to thank Commissioner Hester Peirce, Charles Lee, Steven Levine, Holly Hunter-Cici, Gabe Eckstein, Rob Fisher, Benjamin Vetter and Lisa Helvin for their insightful comments. Any errors within the article are those of the authors and not those of the individuals who provided comments to the authors.

INTRODUCTION

Towards the end of its 2023-2024 term year, the U.S. Supreme Court issued a number of decisions affecting administrative law and federal regulators. One particular decision, *SEC v. Jarkesy*,[1] specifically addressed the ability of the U.S. Securities and Exchange Commission (SEC or the "Commission") to seek civil penalties for alleged securities fraud in enforcement matters adjudicated in-house. In *Jarkesy*, the Supreme Court held that, in such a case, "a defendant . . . has the right to be tried by a jury of his peers before a neutral adjudicator."[2] An interpretation of the Supreme Court's opinion is that it reflects constitutional concerns with administrative proceedings that concentrate the roles of prosecutor, judge, and jury in the hands of the Executive Branch.[3]

One of the authors of this article has served at the Commission since 2006, becoming an SEC Commissioner in 2022 and Acting Chairman in 2025. During his entire tenure with the agency, he has been involved on a regular basis in administrative proceedings before the Commission. This Article primarily represents his observations on how the use of administrative proceedings at the Commission has changed during his tenure and how they can be reformed to be an effective tool for removing bad actors from the capital markets in a manner consistent with the Constitution.

The SEC may enforce the securities laws in two ways. First, it may bring civil actions in federal district court seeking civil penalties,

1. 603 U.S. 109 (2024).
2. *Id.* at 140.
3. *Id.*

injunctions, and other remedies.[4] Second, the Commission may institute administrative enforcement proceedings, seeking civil penalties, cease-and-desist orders, and other remedies.[5] The expanded use of administrative proceedings by the SEC after enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 ("Dodd-Frank Act") led to increased criticisms of this choice of venue.[6] Such criticisms, in part, laid the groundwork for litigation that resulted in the Supreme Court's opinion in *Jarkesy*.

This Article is intended to contribute to the public discourse by suggesting a path forward whereby the Commission can use administrative proceedings and administrative law judges (ALJs) in a fair and efficient manner that is consistent with the protections against government actions provided by the U.S. Constitution.

I. BACKGROUND

A. HISTORY OF CONGRESSIONAL AUTHORIZATION AND THE EXPANDED USE OF ADMINISTRATIVE PROCEEDINGS FOR CONTESTED CASES

Federal oversight of the securities markets did not occur until after the great stock market crash known as "Black Tuesday," which caused nearly 5,000 banks to close and led to bankruptcies, high unemployment, wage cuts and homelessness, triggering the Great Depression.[7] In the aftermath of this economic downturn, the U.S. Senate Committee on Banking and Currency held hearings, known as the Pecora[8] hearings, to determine the causes of the Great Depression.[9]

---

4. 15 U.S.C. §§ 77t, 78u(d), 80b–9.

5. 15 U.S.C. §§ 77h–1, 78u–2, 78u–3, 80b–3.

6. *See* Joshua D. Roth et al., *Appointments Clause & SEC Administrative Judges*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 3, 2018), https://corpgov.law.harvard.edu/2018/07/03/appointments-clause-sec-administrative-judges/; *see also* Chip Phinney, *SEC's Increased Use of Administrative Proceedings Draws Criticism and Legal Challenges*, MINTZ (Nov. 12, 2014), https://www.mintz.com/insights-center/viewpoints/2014-11-12-secs-increased-use-administrative-proceedings-draws-criticism.

7. *SEC: Securities and Exchange Commission*, HISTORY (Dec. 6, 2019), https://www.history.com/topics/us-government-and-politics/securities-and-exchange-commission.

8. Ferdinand Pecora was the Banking Committee's lead counsel during the hearings. Pecora revealed at the hearings how some of the most well-respected financial institutions knowingly misled investors, engaged in irresponsible behavior, and offered privileges to inside investors. The hearings subsequently became known as the "Pecora Hearings." *See* DAVID MOSS ET AL., THE PECORA HEARINGS, HARVARD BUSINESS

Following the Pecora hearings, Congress passed the Securities Act of 1933 ("Securities Act"), which required registration of most offers and sales of securities in the United States.[10] One year later, Congress passed the Securities Exchange Act of 1934 ("Exchange Act"),[11] which created the Commission and granted it extensive powers to regulate the securities industry.[12]

When the SEC was first created, its enforcement powers were largely limited to investigations, hearings and seeking injunctions in federal district courts.[13] The only express provision relating to administrative hearings was the ability to suspend or expel members or officers of national securities exchanges.[14]

Two years after its creation, the SEC adopted Rule II(k) of its Rules of Practice, granting the Commission the power to suspend or disbar attorneys, accountants, and other professionals from practicing before the Commission.[15] Rule II(k) would be refashioned over time into Rule 102(e), which now empowers the SEC to "deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter: (1) not to possess the requisite qualifications to represent others; or (2) to be lacking in character or

---

SCHOOL CASE 711-046 (Harv. Bus. Pub. rev. ed. 2018), available at https://www.hbs.edu/faculty/Pages/item.aspx?num=39736.

9. *See generally* S. REP. NO. 1455 (1934).

10. Securities Act of 1933 (Securities Act), Pub. L. No. 73–22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77mm).

11. Securities Exchange Act of 1934 (Exchange Act), Pub. L. No. 73–291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78rr).

12. *See* Exchange Act § 4 (codified as amended at 15 U.S.C. § 78d).

13. *Id.* § 21 (codified as amended in scattered sections of 15 U.S.C. § 78); SEC, ANNUAL REPORT FISCAL YEAR 1935 (1935), https://www.sec.gov/about/annual_report/1935.pdf; *see also* Hon. Jed S. Rakoff, S.D.N.Y., Keynote Address at the PLI Securities Regulation Institute: Is the S.E.C. Becoming a Law Until Itself? (Nov. 5, 2014) (transcript available at https://securitiesdiary.wordpress.com/wp-content/uploads/2014/11/rakoff-pli-speech.pdf).

14. Exchange Act § 19 (codified as amended at 15 U.S.C. § 78s); *see also* Rakoff, *supra* note 13, at 3.

15. SEC Rules of Practice as Amended 1936, Rule II(k), 1 Fed. Reg. 1753 (Nov. 7, 1936).

integrity or to have engaged in unethical or improper professional conduct."[16]

The SEC's powers continued to grow when Congress amended the securities laws requiring the registration of brokers and dealers and granting the SEC the power to revoke registration as relief for certain violations.[17] In June 1938, Congress created registered securities associations[18] through the Maloney Act of 1938, codified in Section 15A of the Exchange Act,[19] and the SEC obtained additional powers to suspend or expel members of such associations in certain circumstances.[20] This power was extended in 1964 to allow the SEC to suspend, bar or censure regulated persons who had violated the securities laws from associating with members or registered securities associations.[21]

---

16. The current Rules of Practice expand the Commission's authority by adding a third and fourth subsection to Rule 102(e). 17 C.F.R. § 201.102(e)(1) (2024). Subsection (iii) allows the Commission to deny those the privilege of appearing or practicing before the Commission if they have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws or the rules and regulations thereunder. *Id.* § 201.102(e)(1)(iii). Subsection (iv) defines "improper professional conduct" with respect to accountants under §201.102(e)(1)(ii). *Id.* § 201.102(e)(1)(iv).

17. Exchange Act § 15A, *amended by* Maloney Act of 1938, Pub. L. No. 75–719, 52 Stat. 1070 (codified at 15 U.S.C. § 78o).

18. The first securities association established under the provisions of the Maloney Act was The National Association of Securities Dealers (NASD). This self-regulatory organization ("SRO") was responsible for overseeing market operations and conducting exams, such as the Series 7 exam, for investment professionals. *See generally* Maloney Act of 1938, Pub. L. No. 75–719, 52 Stat. 1070 (codified as amended at 15 U.S.C. § 78o–3); S. REP. NO. 75–1455, at 1070-76 (1938). In 2007, NASD was merged with the regulation, enforcement and arbitration divisions of the New York Stock Exchange and ultimately became the Financial Industry Regulatory Authority (FINRA). *See generally* News Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority (July 30, 2007), available at https://www.finra.org/media-center/news-releases/2007/nasd-and-nyse-member-regulation-combine-form-financial-industry.

19. John D. McGowan, The NASD – Origins, Recent Developments and Future Goals 11(Aug. 1974) (manuscript), https://www.sechistorical.org/collection/papers/1970/1974_0801_NASDOriginsT.pdf.

20. Exchange Act § 15A (codified as amended at 15 U.S.C. § 78o–3); *see also* Rakoff, *supra* note 13, at 4.

21. Securities Act and Exchange Act Amendments of 1964 (1964 Amendments), Pub. L. No. 88–467, § 7(a)(5), 78 Stat. 565, 576 (1964) (codified at 15 U.S.C. § 78o–3(b)(7)); *see also* Rakoff, *supra* note 13, at 4.

Congress cracked open the door to the future use of administrative proceedings when it passed the Securities Enforcement Remedies and Penny Stock Reform Act ("Remedies Act") in 1990, which allowed the SEC to issue cease-and-desist orders and to order disgorgement against "any person," including unregistered entities through an administrative proceeding.[22] A cease-and-desist order is similar to the issuance of an injunction, which can only be issued by a court. Until the Remedies Act was passed, the SEC could only use administrative proceedings to impose sanctions against registered entities.[23] The Remedies Act also allowed the SEC, through administrative proceedings, to collect civil monetary penalties against registered entities.[24] However, to collect civil monetary penalties against non-registered individuals and entities, the Commission was required to file a case in federal court.[25]

Prior to the Remedies Act, the Commission did not have explicit statutory authority to seek officer or director bars in federal court.[26] In a 1987 report, the SEC sought statutory authority to issue officer or director bars through administrative proceedings.[27] However, when Congress granted the Commission the authority to issue officer or director bars, it required that the Commission seek those bars through federal courts and limited the Commission to only seeking bars in cases involving "scienter-based fraud."[28]

Following the passage of the Remedies Act, the Commission undertook an in-depth review of administrative proceedings, forming an

22. Securities Enforcement Remedies and Penny Stock Reform Act of 1990 ("Remedies Act"), Pub. L. No. 101–429, § 101, 104 Stat. 931, 932 (1990) (codified at 15 U.S.C. § 77t(d)); *see also* Dhaivat H. Shah, *The Care and Feeding of an SEC Cease-and-Desist Order: the Commission Defines its Authority Through In the Matter of KPMG Peat Marwick, LLP*, 25 HAMLINE L. REV. 271, 275 (Winter 2002).

23. Shah, *supra* note 22, at 275.

24. Remedies Act § 101 (codified at 15 U.S.C. § 77t(d)); *see also* 15 U.S.C. § 78u–2(a).

25. Erin Bauwens, Note, *The Dodd-Frank Act and Government Overreach: How Expanded SEC Authority Affects the Investing Public and How to Better Regulate the Financial Industry*, 67 SYRACUSE L. REV. 741, 747 (2017).

26. Philip F.S. Berg, Note, *Unfit to Serve: Permanently Barring People from Serving as Officers and Directors of Publicly Traded Companies After the Sarbanes-Oxley Act*, 56 VAND. L. REV. 1871, 1877 (2003).

27. *Id.*; *see also* NAT'L COMM'N ON FRAUDULENT FIN., REPORT 66-67 (1987), https://www.sechistorical.org/collection/papers/1980/1987_1001_TreadwayFraudulent.pdf.

28. Berg, *supra* note 26, at 1877.

internal task force under then-Commissioner Mary Schapiro, to issue recommendations in a public report to create a fair and efficient process.[29] The report, however, was largely focused on expediency and appeared to downplay the need for procedural protections for defendants. The report specifically mentioned the need to address concerns that defendants would "use any procedural tactics" to delay proceedings as increased financial penalties would "create more incentive for defendants to litigate as long as possible."[30]

In 2002, through the Sarbanes-Oxley Act, Congress granted the SEC the expanded power to bar any person who had violated the securities laws from serving as an officer or director of a public company through an administrative proceeding, as opposed to solely through a federal district court.[31] Section 305 modified the Securities Act and the Exchange Act by lowering the standard for issuance of an officer and director bar.[32] Section 1105 allowed the Commission to issue officer and director bars as part of a cease-and-desist proceeding.[33]

The door to bypass federal courts was pushed wide open in 2010 when Congress included Section 929P in the Act, which amended portions of the Securities Act of 1933, the Exchange Act of 1934, and the Investment Advisers Act of 1940 ("Advisers Act").[34] Section 929P authorized the SEC to seek civil monetary damages from "any person" in an administrative proceeding, regardless of whether they are registered with the SEC or the violations require scienter.[35] This change

29. TASK FORCE ON ADMINISTRATIVE PROCEEDINGS, SEC, FAIR AND EFFICIENT ADMINISTRATIVE PROCEEDINGS: REPORT OF THE TASK FORCE (1993) [hereinafter TASK FORCE REPORT].

30. *Id.* at 1-2.

31. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

32. Berg, *supra* note 26, at 1873; Sarbanes-Oxley Act § 305 (amending 15 U.S.C. §§ 78u(d), 77t(e)).

33. Berg, *supra* note 26, at 1873; Sarbanes-Oxley Act § 1105 (amending 15 U.S.C. §§ 78u-3, 77h-1).

34. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 929P, 124 Stat. 1376–63 (2010)(enhancing SEC authority to impose civil penalties in administrative proceedings); Securities Act of 1933, § 8A, 15 U.S.C. § 77h–1, as amended by Dodd-Frank Act § 929P(a); Securities Exchange Act of 1934, § 21B(a), 15 U.S.C. § 78u–2(a), as amended by Dodd-Frank Act § 929P(a); Investment Advisers Act of 1940, § 203(i)(1), 15 U.S.C. § 80b–3(i)(1), as amended by Dodd-Frank Act § 929P(a).

35. H.R. Rep. No. 111–517, at 870 (2010) (stating Subtitle B of Title IX, including Section 929P, clarifies that SEC has "authority to conduct investigations, impose

in the law significantly expanded the universe of individuals and entities that could find themselves subject to an administrative proceeding brought before one of the SEC's ALJs.[36]

This expansion, as Judge Jed Rakoff of the U.S. District Court for the Southern District of New York acknowledged in 2014, resulted almost entirely through SEC requests to Congress citing that the broadened authority "would serve to enhance the [Division of Enforcement's] effectiveness and efficiency".[37] Thus, under current law, the SEC has the "sole discretion to decide whether to bring an enforcement action in federal court or [in] an administrative proceeding."[38]

Subsequently, the Commission started to use its authority to bring more actions in administrative proceedings rather than in federal courts. In February 2015, the then-Director of the SEC's Division of Enforcement touted the "use of the administrative forum in cases where we previously could only obtain penalties in district court."[39] He also rejected any criticism that the proceedings are unfair, pointing out that there is no constitutional right to a jury trial and that the use of administrative proceedings does not result in any due process violations.[40] Several months later, the Division of Enforcement released guidance titled, "Division of Enforcement Approach to Forum Selection in Contested Actions" ("2015 Staff Guidance"), which set forth factors

liability on control persons, and assess penalties for violations of the securities laws..." and "the intent standard in SEC enforcement actions for aiding and abetting is recklessness...").

36. *See* 15 U.S.C. § 78u–2(a)(1), as amended by Dodd-Frank Act § 929P(a).

37. Rakoff, *supra* note 13, at 5-6 (citing *Mortgage Fraud, Securities Fraud, and the Financial Meltdown: Prosecuting Those Responsible Before the S. Comm. on the Judiciary*, 111th Cong. (2009) (statement of Robert Khuzami, Dir., Div. of Enf't, SEC), https://www.sec.gov/news/testimony/2009/ts120909rk.htm).

38. Thomas Glassman, *Ice Skating Up Hill: Constitutional Challenges to SEC Administrative Proceedings*, 16 J. BUS. & SEC. L. 47, 52 (2015); *see also* 15 U.S.C. §§ 78u(d), 78u–1, 78u–2, 78u–3. The *Jarkesy* decision limits the Commission's choices should they plan to seek civil monetary penalties in certain actions. *See* SEC v. Jarkesy, 603 U.S. 109, 115-18 and 139 (2024) (articulating defendants' "right to be tried by a jury of [their] peers before a neutral adjudicator" contrasted against how "there are no juries...when the SEC adjudicates the matter in-house").

39. Andrew Ceresney, Dir., Div. of Enf't, SEC, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), https://www.sec.gov/newsroom/speeches-statements/2014-spch112114ac.

40. *Id.*

that the staff would consider when electing which forum to use for a contested case.[41]

After the Dodd-Frank Act changes, there was a significant shift that resulted in more enforcement cases being filed as administrative proceedings as opposed to in federal district court. Historically, the SEC brought approximately sixty percent of its new cases as administrative proceedings.[42] However, in the first half of fiscal year 2015, it was reported that the Commission filed over eighty percent of its enforcement actions as administrative proceedings.[43]

Critics of the SEC's new approach noted the significant increase in administrative proceedings, especially for insider trading cases. As one media publication reported,

> [i]n fiscal year 2013, the SEC filed only 2 percent of its insider trading cases as administrative proceedings. In contrast, it filed 23 percent of these cases as administrative proceedings in fiscal year 2014. In the first half of 2015, the portion of insider trading enforcements filed as administrative proceedings was 35 percent.[44]

There was some speculation[45] that the shift may have been influenced by the string of six insider trading cases that the Commission lost in federal courts in 2013 and 2014, including cases filed against

---

41. SEC, DIV. OF ENF'T, APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS 1-4 (2015), available at https://www.millerchevalier.com/sites/default/files/resources/FCPAReview/FCPAReviewSummer2015_SEC-Guidance_Division-of-Enforcement-Approach-to-Forum-Selection.pdf. The factors include: (1) availability of the desired claims, legal theories, and forms of relief in each forum; (2) whether any charged party is a registered entity or an individual associated with a registered entity; (3) cost, resource, and time-effectiveness of litigation in each forum; and (4) fair, consistent and effective resolution of securities law issues and matters. *Id.* at 1-4. However, the staff guidance points out that not all factors may be present and leaves it open to the staff as to how they weigh these factors in making a determination, noting that "the Division may in its discretion consider any or all of the factors in assessing whether to recommend that a contested case be brought in the administrative forum or in federal district court." *Id.* at 1.

42. Sara Gilley et al., *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360 (May 27, 2015), https://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup.

43. *Id.*

44. *Id.*

45. *See* Alexander Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAW. 1, 8-9 (2015-2016); *see also* Dave Michaels, *SEC Is Steering More Trials to Judges It Appoints,* WALL ST. J. (Oct. 20, 2014), https://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590.

Manouchehr Moshayedi,[46] Nelson Obus,[47] Rex Steffes and his sons,[48] Ladislav Schvacho,[49] Siming Yang,[50] and Mark Cuban.[51]

From October 2010 through March 2015, the SEC won more than ninety percent of its contested administrative proceedings before SEC ALJs compared to only sixty-nine percent of the cases it brought in federal court during the same time period.[52] Then-Commissioner Michael Piwowar criticized the Division of Enforcement's approach, suggesting that guidelines be implemented that lay out which cases should be brought in administrative proceedings versus in federal courts in order to "avoid the perception that the Commission is taking its tougher cases to its in-house judges."[53] While the Division of Enforcement denied that the move to file more insider trading cases in administrative proceedings was a result of their recent losses in federal court, the timing of the move coupled with the high success rate in administrative proceedings had critics suggesting that it was "an attempt to stack the deck."[54]

B. HOW DO ADMINISTRATIVE PROCEEDINGS WORK?

The SEC follows the framework set forth in the Administrative Procedure Act ("APA")[55] in conducting administrative enforcement proceedings and has the "authority to delegate, by published order or

46. SEC v. Moshayedi, No. 12-CV-01179 (C.D. Cal. June 11, 2014).

47. SEC v. Obus, No. 06-CV-03150 (S.D.N.Y May 30, 2014).

48. SEC v. Steffes, No. 10-CV-06266 (N.D. Ill. Jan. 27, 2014).

49. SEC v. Schvacho, No. 12-CV-2557 (N.D. Ga. Jan. 7, 2014).

50. SEC v. Yang, No. 12-CV-02473 (N.D. Ill. Apr. 4, 2012). The jury in this case found against the Commission on an insider trading claim, but in favor of the Commission on front running and two false filing claims.

51. SEC v. Cuban, No. 08-CV-2050, 2013 WL 287087, at *1 (N.D. Tex. Oct. 16, 2013).

52. Jean Eaglesham, *SEC Wins with In-House Judges*, WALL ST. J. (May 6, 2015), https://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803?msockid=308cb517dd1f6bb60566a101dc176a4e.

53. Michael S. Piwowar, Comm'r, SEC, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly and Efficient SEC (Feb. 20, 2015), http://www.sec.gov/news/speech/022015-spchcmsp.html.

54. Nicholas M. Berg et al., *SEC's Continued Use of Administrative Forum Irks Critics, Raises Sticky Constitutional Questions*, 12 CORP. & L. ACCOUNTABILITY REP. 1772, 1773 (2014).

55. Administrative Procedure Act, 5 U.S.C. §§ 551-59.

rule, any of its functions to a division of the Commission, an individual Commissioner, an [ALJ], or an employee or employee board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any work, business, or matter."[56]

An administrative proceeding refers to an enforcement proceeding under Commission Rule of Practice 101(a)(4), defined as

> an action, initiated by an order instituting proceedings, held for the purpose of determining whether or not a person is about to violate, has violated, has caused a violation of, or has aided and abetted a violation of any statute or rule administered by the Commission, or whether to impose a sanction as defined in Section 551(10) of the [APA].[57]

When the Division of Enforcement recommends an action via administrative proceeding, the staff supports that recommendation in their action memorandum with a draft Order Instituting Proceedings ("OIP"), which serves as the charging document, for Commission approval.[58] The Commissioners vote on whether to approve the OIP, and, if approved, the case would historically be set before an ALJ.[59] The purpose of the OIP is to provide notice to each party to the proceeding and must contain (1) the nature of any hearing; (2) the legal authority and jurisdiction under which the hearing is to be held; (3) a short and plain statement of the matters of fact and law to be considered and determined; and (4) the nature of any relief or action sought or taken.[60]

Leading up to an OIP, the Division of Enforcement conducts investigations into whether any individual or entity violated provisions of the federal securities laws,[61] and these investigations are generally confidential except to the extent that a party to the investigation wishes

---

56. *See* 15 U.S.C. 78d–1(a); 17 C.F.R. §§ 200.30–9, 201.200–.360, 201.410–.411 (2024).

57. SEC Rule of Practice 101(a)(4), 17 C.F.R. § 201.101(a)(4) (2024).

58. See DIV. OF ENF'T, SEC, ENFORCEMENT MANUAL, 13 (2017) [hereinafter SEC, ENFORCEMENT MANUAL], https://www.sec.gov/divisions/enforce/enforcementmanual.pdf. See also U.S. Sec. & Exch. Comm'n's Off. of Sec'y, Information for Respondents in Administrative Proceedings (August 2024), https://www.sec.gov/files/os-ap-guidance-printing-mailing.pdf.

59. The APA authorized executive agencies to conduct administrative proceedings before an ALJ. *See* Glassman, *supra* note 38, at 52 (citing 5 U.S.C. §§ 551–59).

60. SEC Rule of Practice 200, 17 C.F.R. § 201.200(b)(1) –(4) (2024).

61. SEC, ENFORCEMENT MANUAL, *supra* note 58, at 13.

to make it public.[62] The Commission may issue formal orders of investigation, the approval authority for which has been previously delegated to the staff,[63] which, in turn, collect evidence through documents and testimony.[64]

Upon completion of an investigation, staff in the Division of Enforcement has two general choices. First, based on the evidence, legal analysis, and practical considerations,[65] the Division can close the investigation and take no further action.[66] Second, the Division can pursue a resolution that involves some type of action requiring Commission approval.[67] Typically, the Enforcement staff will explore a potential settlement with the defendants,[68] including the violations and remedies. If a settlement is not reached, then the Division may recommend that the Commission authorize a litigated action in either federal district court or an SEC administrative proceeding.

If the Division of Enforcement recommends an enforcement action, then it will present its findings to the Commission in the form of a recommendation.[69] The Division submits an action memorandum to the Commission with the recommendation and the supporting factual and legal foundation.[70] While actions technically are filed by the Commission, in practice, the staff has the ability to recommend to the

62. *Id.* at 82; 17 C.F.R. § 202.5(a) (2024).

63. SEC, ENFORCEMENT MANUAL, *supra* note 58, at 17-18, 24; 17 C.F.R. § 200.30–4(a)(13) (2024). The Commission can call up any formal order by a vote of one single Commissioner, which would cause the entire Commission to review the formal order and vote on whether to grant that formal order. SEC, ENFORCEMENT MANUAL, *supra* note 58, at 23-24; 17 C.F.R. § 200.42 (2024).

64. SEC, ENFORCEMENT MANUAL, *supra* note 58, at 17; *see* Securities Act § 19(c), 15 U.S. Code § 77s(c); Exchange Act § 21(b), 15 U.S. Code § 78u(a)–(b).

65. SEC, ENFORCEMENT MANUAL, *supra* note 58, at 12-16. One example of a practical consideration is if defendants are abroad and whether the Commission would have legal ability to service process.

66. *Id.* at 26-28.

67. *Id.* at 22-23.

68. Danné L. Johnson, *SEC Settlement: Agency Self-Interest or Public Interest*, 12 FORDHAM J. CORP. & FIN. L. 627, 628 (2007).

69. SEC, ENFORCEMENT MANUAL, *supra* note 58, at 22-23, 26-27. The Division of Enforcement can also close out an investigation for no further action; such a decision does not require Commission approval.

70. *Id.* at 22-23.

Commission what charges should be included, where the action should be filed, and whether the action should be litigated or settled.[71]

The SEC Rules of Practice make clear that "[a]ll proceedings shall be presided over by the Commission or, if the Commission so orders, by a hearing officer,"[72] which most commonly means an ALJ for the purposes of SEC administrative proceedings. Currently, open ALJ positions are posted on USAJobs, and after a review of resumes, a panel interviews a selected number of applicants. That interview panel then recommends the top tier of candidates to meet with the Chairman and Commissioners, after which the Commission selects and appoints new ALJs by vote.[73]

Typically, after the Commission approves an OIP, the administrative proceeding commences before an ALJ, who takes evidence, assesses the veracity of the allegations outlined in the OIP, and issues an initial decision.[74] Initial decisions are subsequently sent to the Commission, which may then issue a finality order.[75] Currently, the practice before the Commission involves setting the matter before the Commission, as opposed to an ALJ, when there are no disputed issues of material fact. If the Commission determines that there is a need for a fact-finder to adjudicate any factual disputes, the Commission is able to send the matter to an ALJ to act as a hearing officer and to make factual findings.[76] The hearing officer has "the authority to do all things necessary and appropriate to discharge his or her duties."[77] This includes, but is not limited to, administering oath and affirmations, issuing subpoenas, receiving relevant evidence and ruling on its

71. *Id.* at 23. Settled actions can also be filed in federal court or as an administrative cease-and-desist proceeding. However, the focus of this article is on litigated actions and will not substantively discuss settled SEC actions.

72. 17 C.F.R. § 201.110 (2024).

73. This process at the Commission is subject to change based on what the Commission determines is appropriate. Admin. Conf. of the U.S., Recommendation 2019-2, *Agency Recruitment and Selection of Administrative Law Judges*, 84 Fed. Reg. 38,930 (Aug. 8, 2019).

74. 17 C.F.R. § 201.360(b) (2024); *see* U.S. Sec. & Exch. Comm'n's Off. of Sec'y, *Information for Respondents in Administrative Proceedings, supra* note 58, at 1.

75. 17 C.F.R. § 201.360(b)(1) (2024); *see* U.S. Sec. & Exch. Comm'n's Off. of Sec'y, *Information for Respondents in Administrative Proceedings, supra* note 58, at 2.

76. *See, e.g.*, Lemelson, Release No. AP-6911, SEC File No. 3-20828, 2024 SEC LEXIS 2869 (ALJ Oct. 24, 2024) (prehearing conference order) (directing a public hearing before an ALJ following the Commission's order).

77. SEC Rule of Practice 111, 17 C.F.R. § 201.111 (2024).

admissibility, holding prehearing and other conferences, ruling on procedural and other motions, and preparing an initial decision.[78]

In an administrative proceeding, the Division of Enforcement has a role similar to a private litigant appearing before the ALJ. Staff from the Division of Enforcement will attend pre-hearing conferences,[79] may request subpoenas[80] or depositions,[81] and may also file motions,[82] and otherwise represents the Division in the administrative proceeding. Commission rules prohibit *ex parte* communications stating that,

> the person presiding over an evidentiary hearing may not (1) [c]onsult a person or party on a fact in issue, unless on notice and opportunity for all parties to participate; or (2) [b]e responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for the Commission.[83]

SEC Rule of Practice 121 specifically requires the separation of functions, stating that,

> [a]ny Commission officer, employee or agent engaged in the performance of investigative or prosecutorial function for the Commission . . . may not, in that proceeding or one that is factually related, participate or advise in the decision, or in Commission review of the decision . . . , except as a witness or counsel in the proceeding.[84]

However, this rule does not apply to the Chair or individual Commissioners. The Commission's Office of General Counsel Adjudications Group (the "Adjudications Group") effectively advises and assists the Commission in order to establish this wall between the Division of Enforcement and the Commission as it relates to administrative proceedings.[85]

---

78. *Id.*
79. SEC Rule of Practice 221, 17 C.F.R. § 201.221 (2024).
80. SEC Rule of Practice 232, 17 C.F.R. § 201.232 (2024).
81. SEC Rule of Practice 233, 17 C.F.R. § 201.233 (2024).
82. SEC Rule of Practice 250, 17 C.F.R. § 201.250 (2024).
83. SEC Rule of Practice 120, 17 C.F.R. § 201.120 (2024).
84. SEC Rule of Practice 121, 17 C.F.R. § 201.121 (2024).
85. U.S. Sec. & Exch. Comm'n, *Commission Statement Relating to Certain Administrative Adjudications*, SEC (Apr. 5, 2022), https://www.sec.gov/newsroom/

In any proceeding in which the Commission directs a hearing officer to preside at a hearing, the hearing officer shall prepare an initial decision.[86] "An initial decision shall include findings and conclusions, and the reasons or basis therefor, as to all the material issues of fact, law or discretion presented on the record and the appropriate order, sanction, relief, or denial thereof."[87] Unless a party or aggrieved person entitled to review timely files a petition for review of the initial decision or a motion to correct a manifest error of fact with the hearing officer, the Commission will enter an order of finality.[88]

Pursuant to Section 704 of the APA,[89] a petition to the Commission for review of an initial decision is a prerequisite before judicial review of a final order can be sought in an Article III court.[90] Thus, the losing party must initially appeal the adverse decision to the Commission before appealing to the U.S. Court of Appeals for the District of Columbia or to the circuit to which the defendant resides or has their principal place of business.[91] Once the matter is subject to Commission review, the Commission "may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record";[92] essentially, the matter is being reviewed de novo and the Commission is not required to give deference to any of the ALJ's rulings.[93]

There is no obligation of the Commission to fully defer to the findings of the ALJ.[94] To the knowledge of the authors, staff of the

---

speeches-statements/commission-statement-relating-certain-administrative-adjudications.

86. SEC Rule of Practice 360, 17 C.F.R. § 201.360(a)(1) (2024). The initial decision can be waived by the parties with the consent of the hearing officer. *Id.*

87. SEC Rule of Practice 360(b), 17 C.F.R. § 201.360(b) (2024).

88. *Id.* The Commission may also decide to review the initial decision on its own initiative. *Id.*

89. 5 U.S.C. § 704.

90. SEC Rule of Practice 410(e), 17 C.F.R. § 201.410(e) (2024).

91. *See id.*

92. SEC Rule of Practice 411, 17 C.F.R. § 201.411 (2024).

93. Daniel R. Walfish, *The Real Problem with SEC Administrative Proceedings, and How to Fix It*, FORBES (July 20, 2015), https://www.forbes.com/sites/danielfisher/2015/07/20/the-real-problem-with-sec-administrative-proceedings-and-how-to-fix-it/.

94. In Flannery v. SEC, 810 F.3d 1, 9 (1st Cir. 2015), the First Circuit quotes NLRB v. International Brotherhood of Teamsters Local 251, 691 F.3d 49, 55 (1st Cir. 2012) (alterations in original), stating that "evidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the

Adjudication Group does not participate in actual hearings presided over by an ALJ. The Adjudication Group, as part of their role in assisting the Commission, has the ability to re-draft the factual findings, legal analysis, and other aspects of the final Commission opinion within the confines of the administrative record and the applicable law and regulations.[95]

In addition to instances where the losing party petitions for Commission review, "[t]he Commission may, on its own initiative, order review of any initial decision, or any portion of any initial decision, within 21 days after the end of the period established for filing a petition for review pursuant to [Rule 410]."[96] The Commission then has the ability to establish a briefing schedule and order briefs,[97] order oral arguments,[98] and allow for the submission of additional evidence.[99] A motion for reconsideration of a final Commission order can be filed within ten days after service of the final order.[100] Once a Commission order is final, the "decision becomes the authoritative decision of the agency, which can then be appealed to a federal court of appeals."[101]

II. EVEN WHEN DEFENDANTS "WIN" BEFORE THE ALJ, THEY CAN "LOSE" UPON COMMISSION REVIEW

There has been much discussion about the Division of Enforcement's "win" record in matters before the ALJs.[102] Less has been discussed about the outcome where even if the defendants prevail in an initial decision after a proceeding before they ALJ, they can lose on

witnesses and lived with the case has drawn conclusions different from the [Commission]'s than when [the ALJ] has reached the same conclusion." In such situations, the court's review "is slightly less deferential than it would be otherwise." *Id.*

95. The Commission has repeatedly asserted that it makes a decision based on its "independent review of the record." *E.g.*, Aesoph, Exchange Act Release No. 78490, 2016 WL 4176930, at *3 (Aug. 5, 2016) (Comm'n Op.); *see also Flannery*, 810 F.3d at 9.

96. SEC Rule of Practice 411, 17 C.F.R. § 201.411(c) (2024).

97. SEC Rule of Practice 450, 17 C.F.R. § 201.450 (2024).

98. SEC Rule of Practice 451, 17 C.F.R. § 201.451 (2024).

99. SEC Rule of Practice 452, 17 C.F.R. § 201.452 (2024).

100. SEC Rule of Practice 470, 17 C.F.R. § 201.470(b) (2024).

101. Walfish, *supra* note 93.

102. *See* Eaglesham, *supra* note 52; Gilley et al., *supra* note 42; Berg et al., *supra* note 54, at 2.

review to the Commission, which is the body that filed the action in the first place. Prior to *Lucia v. SEC*,[103] such outcomes occurred.

A. FLANNERY & HOPKINS

The SEC's decision in *Flannery* illustrates this scenario.[104] In the period leading up to the financial crisis of 2008, John P. Flannery and James D. Hopkins were employed by State Street Global Advisers ("SSgA") and were involved with the offer and sale of the Limited Duration Bond Fund.[105] The fund was heavily invested in asset-backed securities, including residential mortgage-backed securities.[106] During the financial crisis, the value of the holdings was affected, and many investors in the fund redeemed their interests.[107]

Flannery and Hopkins were accused in September 2010 of violating various antifraud provisions of the federal securities laws in connection with the communications relating to the fund.[108] In October 2011, the chief ALJ for the SEC issued her initial decision, reached after an 11-day hearing, 19 witnesses (including five expert witnesses), about 500 exhibits, and seven briefs totaling 442 pages of argument.[109] In her 58-page initial decision, the chief ALJ decided in favor of the defendants and found them not liable for the alleged violations.[110]

The Division of Enforcement, which acts under the supervision and authority of the Chairman, then appealed the chief ALJ's decision to the Commission.[111] The Adjudication Group, which structurally reports to the Chair through the General Counsel, would have assisted the

103. 585 U.S. 237 (2018).

104. Flannery, Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Company Act Release No. 31374, 2014 WL 7145625 (Dec. 15, 2014) (Comm'n Op.).

105. *Id.* at *3.

106. *Id.*

107. *Id.* at *4.

108. Flannery, Securities Act Release No. 9147, Exchange Act Release No. 63018, Investment Company Act Release No. 29451, 2010 WL 3826277, at *13 (Sept. 30, 2010) (order instituting proceedings ("OIP")).

109. Flannery, SEC Release No. 438, 2011 WL 5130058, at *1 (ALJ Oct. 28, 2011) (initial decision).

110. *Id.* at *57.

111. *See* Division of Enforcement's Petition for Review of Initial Decision, Flannery, No. 3-14081 (Nov. 21, 2011). We are not suggesting that the Division of Enforcement consulted with the Chair on the decision of whether to appeal, which would have amounted to an *ex parte* communication, which is prohibited.

Commission by preparing, circulating, taking feedback on, and finalizing a draft opinion to the Commissioners. In the final decision, issued in December 2014, the Commission reached the opposite decision of the ALJ and found the defendants liable for antifraud violations and imposed a range of remedies. Three of the Commissioners voted in favor, while two Commissioners dissented.[112]

Flannery and Hopkins disagreed with the SEC's final decision and appealed to the U.S. Court of Appeals for the First Circuit.[113] On appeal, the SEC's final opinion is not reviewed de novo nor subject to a preponderance of the evidence standard.[114] In its opinion, the court acknowledged that judicial review of an SEC adjudication decision is limited, and, quoting *Cody v. SEC*,[115] stated that "[t]he SEC's factual findings control if supported by substantial evidence."[116] Within this framework, "substantial evidence" is defined as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."[117]

Even with this relaxed standard, the SEC's final opinion could not withstand judicial scrutiny. In December 2015, the First Circuit vacated the Commission's decision on the grounds that it was not supported by substantial evidence.[118] However, vindication for Flannery and Hopkins came at a significant cost, as more than five years elapsed between the filing of the SEC's OIP and the vacating of the order by the First Circuit.[119]

112. *See* Flannery, 2014 WL 7145625, at *58 (Comm'n Op.) (Gallagher, Comm'r, & Piwowar, Comm'r, dissenting).

113. *See* Flannery v. SEC, 810 F.3d 1, 3-4 (1st Cir. 2015)

114. *Id.* at 8-9.

115. 693 F.3d 251, 257 (1st Cir. 2012).

116. *Flannery*, 810 F.3d at 8-9 (quoting *Cody*, 693 F.3d at 257).

117. *Id.* at 9 (quoting Penobscot Air Servs., Ltd. v. FAA, 164 F.3d 713, 718 (1st Cir. 1999)).

118. *Id.* at 15.

119. The OIP was filed on Sept. 30, 2010; the First Circuit's decision was released on December 5, 2015. *Flannery*, 2010 WL 3826277, at *1 (OIP); *Flannery*, 810 F.3d at 1.

B. AESOPH & BENNETT

John J. Aesoph and Darren M. Bennett were certified public accountants with KPMG, LLP.[120] They were involved in the 2008 audit of TierOne Bank's financial statements.[121] The Commission alleged they were negligent and had engaged in "improper professional conduct" under SEC Rule of Practice 102(e)[122] with respect to TierOne's loss estimates for impaired commercial real estate loans recorded in the bank's allowance for loan and lease losses.[123] Like *Flannery*, this enforcement action involved events relating to the 2008 financial crisis.[124]

Unlike Flannery and Hopkins, the SEC ALJ found in favor of the Division of Enforcement in her initial decision.[125] In reaching her decision, the ALJ presided over nine days of hearings, admitting numerous exhibits.[126] The Division of Enforcement called five witnesses, including two experts, and the defendants testified on their own behalf and called two of their own experts.[127]

While the ALJ noted that the defendants were "highly regarded at their firm," "recognized risks" associated with the allowance for loan and lease losses, worked more on the 2008 audit than on the previous audit, and "adequately conducted other areas of the audit," she concluded that there was still a lack of due care and failure to obtain sufficient evidence to support their audit judgments.[128] She also considered numerous other Commission precedents in reaching her decision to impose sanctions and suspend Aesoph for one year and to suspend Bennett for six months.[129]

---

120. Aesoph, Exchange Act Release No. 68605, 2013 WL 98717, at *3 (Jan. 9, 2013) (OIP).

121. *Id.* at *1-2.

122. 17 U.S.C. § 201.102(e) (2024).

123. *Aesoph*, 2016 WL 4176930, at *2-3 (Comm'n Op.).

124. *Id.* at *3; *Flannery*, 2014 WL 7145625, at *4 (Comm'n Op.).

125. Aesoph, SEC Release No. 624, 2014 WL 2915931, at *38 (ALJ June 27, 2014) (initial decision).

126. *Id.* at *2.

127. *Id.*

128. *Id.* at 37.

129. *Id.* at 36 (first citing McCurdy v. SEC, 396 F.3d 1258, 1264-65 (D.C. Cir. 2005); then citing Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); and then citing Steven Altman, Esq., Exchange Act Release No. 63306 (Nov. 10, 2010), 99 SEC Docket 34405, 34435, *petition denied*, 666 F.3d 1322 (D.C. Cir. 2011)).

Aesoph and Bennett appealed the initial decision to the Commission.[130] The SEC's Division of Enforcement cross-appealed,[131] arguing that the Commission should impose the longer suspension terms the Division originally requested during the ALJ hearing stage: a three-year suspension for Aesoph and a two-year suspension for Bennett.[132] In its final decision, not only did the Commission uphold the charges against Aesoph and Bennett, it handed down harsher sanctions than the Division had requested—imposing on both the defendants a permanent bar of the "privilege of appearing or practicing before [the Commission]" as accountants.[133] As summarized by then-Commissioner Michael S. Piwowar in a separate decision concurring in part and dissenting in part:

By imposing a permanent bar with the right to apply for reinstatement after three years and two years, the majority of the Commission has imposed a punitive sanction that goes far beyond what the Division requested. There is a significant difference between a three-year and two-year suspension as compared to a bar with the right to apply for reinstatement after three years and two years. Under a suspension, the Respondents would be free to resume practicing or appearing before the Commission when the suspension ends. Under a bar with the right to apply for reinstatement, once the requisite time period has passed, Respondents will only be no longer prohibited from seeking reinstatement from the Commission. They must still file a petition with the Commission even to be considered for reinstatement.

Petitions for accountant reinstatements are first evaluated by our Office of the Chief Accountant and, if satisfactory, are then recommended to the Commission for approval. There are no deadlines for the Commission or its staff to complete this process. Pursuant to Rule 102(e)(5) of our Rules of Practice, the Commission may, but is not

130. Respondent John J. Aesoph's Petition for Commission Review of Initial Decision, Aesoph, No. 3-15168 (August 11, 2014); Respondent Darren M. Bennett's Petition for Commission Review of Initial Decision, Aesoph, No. 3-15168 (August 11, 2014).

131. Division of Enforcement's Petition for Review of Initial Decision, Aesoph, No. 3-15168 (August 11, 2014).

132. Division of Enforcement's Opening Brief in Support of its Petition for Review at 4, Aesoph, No. 3-15168 (August 11, 2014).

133. *Aesoph*, 2016 WL 4176930, at *3, *23 (Comm'n Op.). The Commission, however, stipulated that the defendants could apply for reinstatement after a set period: Aesoph after three years and Bennett after two years. *Id.*

obligated, to reinstate a person "for good cause shown." Based on my experience as Commissioner, the reinstatement process, even if successful, can take years to complete after the requisite time period has expired. Moreover, since there is no assurance that a petition for reinstatement will be granted by the Commission, the right to apply for reinstatement can be illusory.[134]

Hence, in order to be eligible to appeal to an Article III court, defendants undertake a very real risk of a harsher determination and set of remedies from the Commission as compared to the ALJ's decision.

C. IMPLICATIONS OF *FLANNERY* AND *AESOPH*

Both *Flannery* and *Aesoph* raise significant concerns with both the substance and optics regarding the fairness of administrative proceedings. As demonstrated by both cases, even if the defendants prevail before the ALJ in an initial decision, the Division of Enforcement can request that the Commission issue a different final decision.[135] Moreover, the defendants will have to spend more time and resources on another round of proceedings within the SEC.[136] Only after that process has been completed can a defendant seek review before an Article III court.[137]

While some would expect a de novo review upon having a case heard before an Article III court, the reviewing court gives significant deference to the factual findings and decision of the agency. Prior to the Supreme Court's decision in *Loper Bright v. Raimondo*,[138] in the event of an ambiguity in the law, the reviewing court was obligated under

134. *Id.* at *2 (Piwowar, Comm'r, concurring in part and dissenting in part). Although Commissioner Piwowar's opinion is included in the same SEC Release as the majority opinion, the document's pagination restarts following the conclusion of the majority opinion.

135. *See* Flannery, Securities Act Release No. 9689, Exchange Act Release No. 73840, Investment Company Act Release No. 31374, 2014 WL 7145625 (Dec. 15, 2014) (Comm'n Op.); *Aesoph*, 2016 WL 4176930 (Comm'n Op.).

136. Should the Commission remand the matter to the ALJ to adduce additional evidence, this would require more time and effort before the ALJ and then another round of review at the Commission level before being eligible for review by a court of appeal. *See, e.g.*, SEC Rules of Practice 410-11, 450-52, 470, 17 C.F.R. §§ 201.410-11, .450-52, .470 (2024) (outlining the multitude of stages and procedures required in SEC enforcement proceedings).

137. SEC Rule of Practice 410(e), 17 C.F.R. § 201.410(e) (2024).

138. 144 S. Ct. 2244 (2024).

Chevron U.S.A., Inc. v. NRDC[139] to defer to the agency's interpretation provided the statute is ambiguous and the interpretation is reasonable. Even after *Loper Bright*, the views of the SEC and other administrative agencies are likely to have some degree of persuasiveness from a court on their legal interpretations.[140]

Aesoph is also a cautionary tale, but for a different reason. In this case, the defendants disagreed with the initial decision.[141] In order to obtain judicial review by an Article III court, the defendants are required to first petition for review by the Commission.[142] As a result of its appeal to the Commission, the defendants received sanctions that were harsher than those initially imposed by the ALJ and even those sought by the Division of Enforcement.[143] This places defendants in the untenable position of either foregoing their right to review from an independent judiciary or potentially facing more severe sanctions.

This result appears to be an intended feature of an administrative proceeding, not a design oversight. Most SEC enforcement actions are resolved by settlement, not litigation. The many hurdles facing defendants before being able to go to court can place significant pressure on them to settle, even if the defendants believe that they did not commit the alleged acts. The pressure to settle becomes even greater if defendants incur legal and expert witness fees in excess of their means, rendering them unable to continue litigation and incentivizing settlement.

III. CONSTITUTIONAL CHALLENGES AND THE EFFECT ON THE SEC

139. 467 U.S. 837 (1984). *See also* Harper F. Brown, Brooke D. Clarkson & James G. Lundy, *The End of the Chevron Deference and Implications for the SEC*, NAT'L L. REV. (July 3, 2024), https://natlawreview.com/article/end-chevron-deference-and-implications-sec.

140. *See* Kisor v. Wilkie, 588 U.S. 558, 568-9 (2019) (holding that *Auer* deference is rooted in the presumption that Congress would generally want the agency to play the primary role in resolving regulatory ambiguities, especially ones grounded in policy concerns).

141. Respondent John J. Aesoph's Petition for Commission Review of Initial Decision, *Aesoph*, No. 3-15168 (Aug. 12, 2014), available at https://www.sec.gov/enforcement-litigation/administrative-proceedings/3-15168; Respondent Darren M. Bennett's Petition for Commission Review of Initial Decision, *Aesoph*, No. 3-15168 (Aug. 12, 2014), available at https://www.sec.gov/enforcement-litigation/administrative-proceedings/3-15168.

142. 28 U.S.C. § 2112(a).

143. *Aesoph*, 2016 WL 4176930, at *3, *23 (SEC Aug. 5. 2016).

ADMINISTRATIVE PROCEEDING

A. EARLY CONSTITUTIONAL CHALLENGES

The perceived unfairness—and the limited efforts of the Commission to address such failings[144]—contributed to setting the stage for full-blown constitutional challenges on the Commission's administrative proceedings. A variety of constitutional claims have been levied against the administrative proceedings process over the years.[145] Historically, however, federal courts rarely examined these constitutional claims in detail, consistently ruling instead that they lack subject matter jurisdiction under *Thunder Basin Coal Co. v. Reich*.[146] Therefore, in most cases, constitutional challenges could only be raised in the federal courts after the completion of entirety of the SEC administrative proceeding.[147]

Despite this historical reluctance, since the Dodd-Frank Act, federal courts have increasingly found that the courts possess the necessary subject matter jurisdiction to review constitutional challenges to the SEC's use of administrative proceedings.[148] Therefore, it is increasingly important to understand the constitutional arguments that have been made which may be considered more thoroughly by the courts going forward.

---

144. For instance, the additional procedural safeguards granted to defendants in administrative proceedings in 2015 could arguably be described as mere "window dressing" that did not address the core concerns with the process. *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015), https://www.sec.gov/newsroom/press-releases/2015-209. *See also* Drew Thornley & Justin Blount, *SEC In-House Tribunals: A Call for Reform*, 62 VILL. L. REV. 261, 278-82 (2017) (discussing the lack of procedural protections in administrative proceedings compared to those found in federal court).

145. *See, e.g.*, Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011) (challenging SEC enforcement proceeding under Equal Protection Clause).

146. 510 U.S. 200 (1994) (setting forth a three-part test to determine whether a district court possesses requisite subject matter jurisdiction for review these constitutional claims); Glassman, *supra* note 38, at 64.

147. By not being able to raise constitutional challenges until after the completion of the SEC administrative proceeding, defendants are forced to expend significant resources defending themselves before being given the ability to raise constitutional challenges. Should the constitutional challenge be granted, those expended resources would ultimately have been unnecessary.

148. Glassman, *supra* note 38, at 65.

1. Due Process

Due Process challenges generally argue that SEC administrative proceedings violate the Fifth Amendment's Due Process Clause by failing to provide defendants with the same due process protections guaranteed in federal court proceedings.[149]

This claim centers on "procedural unfairness";[150] defendants in SEC administrative proceedings must adhere to Commission-established rules, deadlines, and procedures, which are set without consideration of the specific complexities or unique aspects of each case, as argued by proponents of this challenge.[151] Without the safeguards afforded in federal court, defendants are effectively deprived of a fair hearing in administrative proceedings.[152]

Due Process challenges to SEC administrative proceedings have been raised in various forms and with varying results across numerous cases.[153] One style of Due Process challenge argues simply that defendants' due process rights are violated in administrative proceedings because they lack "certain guaranteed procedures," such as the right to take depositions, which are normally available in federal courts, and the allowance of hearsay evidence, which is generally prohibited in federal courts.[154] Alternatively, others have argued that their rights are violated "because they are forced to complete an unconstitutional proceeding in order to appeal that proceeding's constitutionality."[155]

---

149. *Id.*, at 65-66.

150. Chau v. SEC, 72 F. Supp. 3d 417, 428 (S.D.N.Y. 2014), *aff'd*, No. 15-461, 2016 WL 7036830 (2d Cir. Dec. 2, 2016).

151. *Id.* at 426; Memorandum of Law in Support of Plaintiffs' Motion for Temporary Restraining Order & Preliminary Injunction at 6, Chau v. SEC, 72 F. Supp. 3d 417, 428 (S.D.N.Y. June 6, 2014) (No. 14-Civ.-1903).

152. Glassman, *supra* note 38, at 65-66; Memorandum of Law, *supra* note 151, at 6.

153. *See* Glassman, *supra* note 38, at 65-67 (first citing Duka v. SEC, 103 F. Supp. 3d 382, 392 (S.D.N.Y. 2015); then citing Hill v. SEC, 114 F. Supp. 3d 1297, 1307 (N.D. Ga. 2015); and then citing Tilton v. SEC, No.15-CV-2472 RA, 2015 WL 4006165, at *6-7 (S.D.N.Y. June 30, 2015)).

154. *Id.* at 67 (first citing *Chau*, 72 F. Supp. 3d; and then citing Bebo v. SEC, 15-C-3, 2015 WL 905349, at *1 (E.D. Wis. Mar. 3, 2015)).

155. *Id.* at 66 (first citing Tilton v. SEC, No.15-CV-2472 RA, 2015 WL 4006165, at *6-7 (S.D.N.Y. June 30, 2015); then citing *Chau*, 72 F. Supp. 3d; then citing Duka v. SEC, 103 F. Supp. 3d 382, 392 (S.D.N.Y. 2015); and then citing Hill v. SEC, 114 F. Supp. 3d 1297, 1307 (N.D. Ga. 2015)).

Unfortunately, many of the Due Process challenges were not reviewed by the federal courts, which believed that they did not have the subject matter jurisdiction to hear the arguments.[156]

2. Equal Protection

Equal Protection challenges, in essence, argue that defendants in SEC administrative proceedings experience "uniquely unfavorable treatment" compared to similarly situated defendants who face SEC lawsuits in federal court, constituting a violation of the Equal Protection Clause of the Fourteenth Amendment.[157]

Gupta v. SEC was the first litigated action making this equal protection argument.[158] Gupta was one of twenty-one other individuals and seven entities accused of insider trading related to Galleon Management, L.P.[159] However, his case was uniquely brought as an SEC administrative action; for the remaining twenty-eight, the Commission filed complaints in federal district court, using language substantially similar to that in its OIP against Gupta.[160] Gupta responded by filing a Complaint for Declaratory and Injunctive Relief against the SEC in the Southern District of New York, and the subsequent case was assigned to Judge Jed Rakoff.[161]

On April 1, 2011, the SEC moved to dismiss Gupta's complaint on various grounds.[162] The court denied the motion, agreeing to hear Gupta's equal protection claim.[163] Judge Rakoff, in his opinion, wrote: "[W]e have the unusual case where there is already a well-developed public record of Gupta being treated substantially disparately from 28 essentially identical defendants, with not even a hint from the SEC, even in their instant papers, as to why this should be so."[164]

---

156. *Id.*; *see also* Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011); Duka v. SEC, 103 F. Supp. 3d 382, 392 (S.D.N.Y. 2015); Hill v. SEC, 114 F. Supp. 3d 1297, 1307 (N.D. Ga. 2015).

157. Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. PA. J. CONST. L. 45, 86 (Oct. 2016); *see also* U.S. CONST. amend. XIV, § 1; *see, e.g.*, Bebo v. SEC, 799 F.3d 765, 768 (7th Cir. 2015) (noting equal protection and due process arguments raised by defendant).

158. 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

159. *Id.* at 506.

160. *Id.*

161. *Id.*

162. *Id.* at 507.

163. *Id.*

164. *Id.* at 514; *see also* Mark, *supra* note 157, at 87.

The SEC did not seek reconsideration of its motion to dismiss Gupta's district court complaint, but instead dismissed the administrative proceeding against Gupta, who was then charged with several counts of securities fraud.[165] In June 2012, Judge Rakoff granted the SEC's motion for summary judgement.[166]

Since *Gupta*, others have attempted to raise Equal Protection challenges to SEC administrative proceedings in other jurisdictions, possibly motivated by the district court's denial of the SEC's motion to dismiss in *Gupta*, which has been analyzed by others as being "a rare misstep by Judge Rakoff."[167] Those challenges were dismissed in other courts and the equal protection claims similar to those asserted in *Gupta* are viewed as being defective.[168]

3. Right to a Jury Trial

Since the passage of the Dodd-Frank Act, defendants have raised challenges to the SEC's administrative proceedings, arguing that they were entitled to a jury trial under the Seventh Amendment.[169] However, until 2024, none of those challenges had been successful.[170]

Prior to *Jarkesy*, the Supreme Court had never held that a defendant is guaranteed a right to a jury trial as opposed to an administrative proceeding.[171] The Supreme Court addressed the issue of jury trials for administrative proceedings in *Atlas Roofing Co. v. Occupational Safety & Health Review Commission*.[172] The Court held that when "public rights" are being litigated, "the Seventh Amendment does not prohibit Congress from assigning the factfinding function and initial adjudication to an administrative forum with which the jury would be

165. Mark, *supra* note 157, at 88.
166. *Id.*
167. *Id.*
168. *Id.*; *see also, e.g.*, Jarkesy v. SEC, 803 F.3d 9, 14 (D.C. Cir. 2015); Chau v. SEC, 72 F. Supp. 3d 417, 431 (S.D.N.Y. 2014), *aff'd*, 665 F. App'x 67 (2d Cir. 2016).
169. Glassman, *supra* note 38, at 69 (first citing Bebo v. SEC, 15-C-3, 2015 WL 905349, at *1 (E.D. Wis. Mar. 3, 2015); then citing Hill v. SEC, 114 F. Supp. 3d 1297, 1307 (N.D. Ga. 2015); and then citing *Chau*, 72 F. Supp. 3d at 417 n.81).
170. *Id.*
171. Mark, *supra* note 157, at 93-94.
172. 430 U.S. 442, 444 (1977).

incompatible."[173] The Supreme Court went on to define a public right in *Granfinanciera, S.A. v. Nordberg*;[174] a public right is "a right arising between the federal government and others, or one where Congress, acting for a valid legislative purpose pursuant to its constitutional powers under Article I, has created a 'seemingly private right that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary.'"[175]

B. THE SUPREME COURT RULINGS ON SEC ADMINISTRATIVE PROCEEDINGS

1. Lucia

In *Lucia v. SEC*, the Supreme Court addressed the issue of whether ALJs are "mere employees" or "Officers of the United States," and, if they are found to be Officers, whether they are constitutionally appointed under the Appointments Clause.[176] The Court determined the need to apply the "significant authority" test,[177] but also examined *Freytag v. Commissioner*,[178] which applied the "significant authority" test to "adjudicative officials who are near-carbon copies of the Commission's ALJs."[179]

The APA directs each agency to appoint as many ALJs as necessary to conduct proceedings in accordance with the APA's main adjudicative provisions.[180] Before *Lucia*, most ALJs were appointed by department heads after a process administered by the Office of Personnel Management (OPM), with agencies being required to select

173. *Id.* at 450. The Court in *Atlas Roofing* defined public rights as cases in which the Government sues in its sovereign capacity to enforce public rights created by statutes Congress has the power to enact. *See id.* at 458.

174. 492 U.S. 33 (1989).

175. *Id.* at 54 (quoting Thomas v. Union Carbide Agric. Prod. Co., 473 U.S. 568, 586, 593–94 (1985)); *see* Mark, *supra* note 157, at 95.

176. 585 U.S. 237, 243 (2018). Prior to *Lucia*, the DC Circuit and the Tenth Circuit were split on this issue. *See id.* (first citing Raymond J. Lucia Cos. v. SEC, 832 F.3d 277 (D.C. Cir. 2016); then citing Bandimere v. SEC, 844 F.3d 1168 (10th Cir. 2016)).

177. *Id.* at 238 ("To qualify as an officer, rather than an employee, an individual . . . must 'exercis[e] significant authority pursuant to the laws of the United States.'") (alteration in original) (quoting Buckley v. Valeo, 424 U.S. 1, 126 (1976)).

178. 501 U.S. 868 (1991).

179. *Lucia*, 585 U.S. at 246.

180. *See* 5 U.S.C. § 556, 3105.

from the list of eligible candidates assembled by OPM despite the rating system not taking subject-matter expertise into account.[181]

Commission ALJs "hold a continuing office established by law."[182] They "receive[] a career appointment,"[183] which is "to a position created by statute, down to its 'duties, salary, and means of appointment.'"[184] The Court then focused on an ALJ's ability to exercise "significant discretion," noting that they have nearly all the same tools as trial judges: the ability to take testimony, conduct trials, rule on the admissibility of evidence, and the power to enforce compliance with discovery orders.[185] Because SEC ALJs exercise all of these duties and powers, the Court held that the SEC's ALJs are "Officers of the United States" and found that the ALJ in Lucia's case was not properly appointed under the Appointments Clause.[186]

While the Court did, in a sense, strike down the ALJ in this matter, it held that the "'appropriate' remedy for an adjudication tainted with an Appointments Clause violation is a new 'hearing before a properly appointed' official."[187] The effects on the SEC in the aftermath of this decision were minimal. ALJs were re-appointed to meet the requirements established in the Appointments Clause[188] and the SEC continued to bring litigated administrative proceedings before ALJs, though the volume was significantly diminished.[189]

---

181. Jack Beerman, *The Future of Administrative Law Judge Selection*, THE REGULATORY REVIEW (Oct. 29, 2019), https://www.theregreview.org/2019/10/29/beermann-administrative-law-judge-selection/.

182. *Lucia*, 585 U.S. at 247.

183. *Id.* at 248 (quoting 5 C.F.R. §930.204(a)).

184. *Id.* (quoting *Freytag*, 501 U.S. at 878); *see also* 5 U.S.C. §§ 556-57, 5372, 3105.

185. *Id.* at 248.

186. *Id.* at 251.

187. *Id.* (quoting Ryder v. United States, 515 U.S. 177, 183, 188 (1995)).

188. Press Release, U.S. Sec. & Exchange Comm'n, SEC Ratifies Appointment of Administrative Law Judges (Nov. 30, 2017), https://www.sec.gov/newsroom/press-releases/2017-215; *In re Pending Administrative Proceedings*, Securities Act Release No. 10440, Exchange Act Release No. 82178, Investment Advisers Act Release No. 4816, Investment Company Act Release No. 32929, 2017 WL 5969234, at *1-3 (Nov. 30, 2017).

189. U.S. Sec. & Exchange Comm'n, Public Database of Close Litigated Administrative Proceedings, available at https://www.sec.gov/enforcement-litigation/administrative-proceedings/closed-litigated-administrative-proceedings.

After the Supreme Court's decision in *Lucia* finding that the appointment of ALJs violated the Appointments Clause of the U.S. Constitution, President Donald Trump signed an executive order, titled "Excepting Administrative Law Judges from the Competitive Service," which listed ALJs as being part of the "excepted" civil service as opposed to "competitive" civil service with the stated purpose of "provid[ing] agency heads with additional flexibility to assess prospective appointees without the limitations imposed by competitive examination and competitive service selection procedures."[190] The Executive Order further states that "[t]his action will also give agencies greater ability and discretion to assess critical qualities in ALJ candidates, such as work ethic, judgment, and ability to meet the particular needs of the agency."[191] After this Executive Order, the SEC's process for the hiring of ALJs changed.[192]

The more significant post-*Lucia* change was when a non-settled administrative proceeding is instituted, the practice was revised to have the matter generally heard by the Commission and not before an ALJ.[193] From a practical standpoint, there is little difference. It is not as if the Commissioners will be convening as a group to hold an administrative proceeding on the matter.[194] Moreover, without the involvement of an ALJ, in a contested administrative proceeding, it is possible that the same Commissioners that authorized the filing of the administrative proceeding will also be tasked with adjudicating the merits of that proceeding. In that sense, the Commission serves as both prosecutor and judge, even if the technical matter of establishing the alleged violations

190. Exec. Order No. 13,843, 83 Fed. Reg. 32755, 32755 (July 10, 2018).

191. *Id.*

192. *See* Ken Barnett, *Raiding the OPM Den: The New Method of ALJ Hiring*, YALE J. ON REG.: NOTICE & COMMENT (July 11, 2018) ("The new hiring model would, from what I can tell, allow agencies to set their own hiring criteria and hire directly without going through OPM's hiring process.")

193. An example of a non-settled matter is the deregistration of an issuer pursuant to Section 12(j) of the Exchange Act.

194. Even Commissioners hearing the matter may not be an appropriate safeguard to the administration of justice. There is no statutory requirement that the Commissioners be attorneys or familiar with the rule of law. *See, e.g.*, 15 U.S.C. § 78d (setting forth the qualifications for Commissioners). For instance, the composition of the Commission as of December 2024 includes two non-lawyers. *See SEC Commissioners*, SEC (Dec. 29, 2020), https://www.sec.gov/about/sec-commissioners. Even to the extent that Commissioners are lawyers, there is no assurance that such Commissioners may have any experience in presiding over legal proceedings of an adjudicatory nature.

rests with the Commission's staff who present the case to the Commission.

2. Jarkesy

In 2013, the SEC initiated an enforcement action against George Jarkesy and Patriot28, LLC through an administrative proceeding for securities fraud, seeking remedies including civil penalties.[195] In 2014, the presiding ALJ issued an opinion against Jarkesy, which was reviewed by the Commission, and a final order against Jarkesy and Patriot28 was released in 2020.[196] The final order, which found Jarkesy and Patriot28 liable for the charged violations, imposed a $300,000 civil penalty, directed Jarkesy and Patriot28 to cease-and-desist committing or causing violations of the anti-fraud provisions, ordered Patriot28 to disgorge earnings, and prohibited Jarkesy from participating in the securities industry and in offerings of penny stocks.[197]

Jarkesy and Patriot28 petitioned the Fifth Circuit Court of Appeals for judicial review, which was granted and the final order was vacated.[198] The Fifth Circuit determined that, under *Granfinanciera*, because the SEC's antifraud claims are "akin to [a] traditional action[ ] in debt," the cause would be required to be heard before a jury in an Article III court.[199] The panel then considered whether the "public rights" exception applied, concluding that it did not and therefore, the case should have been brought in federal court before a jury.[200] The Fifth Circuit vacated the final order based on what they viewed as a violation of Jarkesy and Patriot28's Seventh Amendment rights.[201]

The Supreme Court held that when the SEC seeks civil penalties against a defendant for securities fraud, the Seventh Amendment entitles

195. SEC v. Jarkesy, 603 U.S. 109, 115-17 (2024).

196. *Id.* at 117-19; *see also* Petition for Writ of Certiorari, *Jarkesy*, 603 U.S. 109, at 4-5 (No. 22-859).

197. *Jarkesy*, 603 U.S. at 119-20.

198. *Id.*; *see* Jarkesy v. SEC, 34 F.4th 446 (5th Cir. 2022).

199. *Jarkesy*, 603 U.S. at 119-20 (alterations in original) (citing *Jarkesy*, 34 F.4th at 453-55).

200. *Id.* (citing *Jarkesy*, 34 F.4th at 455-59).

201. *Id.* (citing *Jarkesy*, 34 F.4th at 459). The Fifth Circuit found the enforcement action to be unconstitutional in three ways, also addressing the non-delegation doctrine and removal under Article II. *See id.* (citing *Jarkesy*, 34 F.4th at 459-66).

a defendant to a jury trial.[202] The Court followed the analysis set forth in *Granfinanciera* and *Tull v. United States*[203] in finding that the Seventh Amendment is implicated because "[t]he SEC's antifraud provisions replicate common law fraud" and finding that "the 'public rights' exception to Article III jurisdiction . . . . does not apply here because the present action does not fall within any of the distinctive areas involving government prerogatives where the Court has concluded that a matter may be resolved outside of an Article III court, without a jury."[204]

Digging into this a little further, the Court stated that the "Seventh Amendment extends to a particular statutory claim if the claim is 'legal in nature'"[205] and highlighted the importance of the remedy, i.e., the monetary relief sought by the Commission.[206] "[A] monetary remedy is legal [in nature] if it is designed to punish or deter the wrongdoer . . . [rather than] solely to 'restore the status quo.'"[207] "[T]he SEC is not obligated to return any money to victims," thereby making civil penalties "'a type of remedy at common law that could only be enforced in courts of law,'" and thus implicating the Seventh Amendment.[208]

The government[209] argued that the public rights exception applied and therefore a jury trial was not required because "Congress created 'new statutory obligations, impose[d] civil penalties for their violation, and then commit[ted] to an administrative agency the function of deciding whether a violation ha[d] in fact occurred.'"[210] The Court described "public rights" as matters that "historically could have been determined exclusively by [the executive and legislative] branches."[211] The fact that the SEC action originated before an administrative proceeding does not "permit Congress to siphon [it] away from an

202. *Id.* at 110.

203. 481 U.S. 412 (1987).

204. *Jarkesy*, 603 U.S. at 119-21 (first citing Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989); and then citing *Tull*, 481 U.S. 412).

205. *Id.* at 122 (quoting Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 53 (1989)).

206. *Id.* at 122-23.

207. *Id.* at 123 (quoting *Tull*, 481 U.S. at 422).

208. *Id.* at 123-24 (citing and quoting *Tull*, 481 U.S. at 421-23).

209. Before the Supreme Court, the Solicitor General and The Securities and Exchange Commission are listed as petitioners in the case. *Id.* at 115.

210. *Id.* at 135 (alterations in original) (quoting Brief for Petitioner, *Jarkesy*, 603 U.S. 109, at 21 (No. 22-859)).

211. *Id.* at 134 (alterations in original) (citing Stern v. Marshall, 564 U.S. 462, 493 (2011)).

Article III court" and it's the substance of the suit that matters, "not where it is brought, who brings it, or how it is labeled."[212]

In his concurring opinion, Justice Gorsuch chides the government's view that "'at a minimum, [the public rights exception] allows Congress to create new statutory obligations, impose civil penalties for their violation, and then commit to an administrative agency the function of deciding whether a violation has in fact occurred.'"[213] The government, in its brief, argues that the case against Mr. Jarkesy is "'brought by the government against a private party' under a statute designed 'to remedy harm to the public at large'" and therefore, the case easily meets the standard.[214] Justice Gorsuch, however, expressed his concern with this reasoning, stating that, "[t]he authority the government seeks (and the dissent would award) in this case—to penalize citizens without a jury, without an independent judge, and under procedures foreign to our courts—certainly contains no such limits."[215] He pointed out that "the Constitution built 'high walls and clear distinctions' to safeguard individual liberty" and that the SEC was free to pursue all of its charges against Mr. Jarkesy in the same manner as they had pursued charges against other individuals prior to 2010: in a court, before a judge and a jury.[216]

3. Axon Enterprises

The Supreme Court's decision in *Axon Enterprise, Inc. v. FTC* and *SEC v. Cochran*[217] allowed defendants to proceed directly to a district court to challenge the agency's methods for appointing ALJs, as opposed to being required to wait until after the adjudication process was complete.[218] The court, in a 9-0 decision, applied the three-factor test in *Thunder Basin*, and ultimately determined that certain challenges should be allowed to be made prior to the conclusion of the

212. *Id.* at 135 (citing Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 52 (1989)).

213. *Id.* at 152-53 (Gorsuch, J., concurring) (quoting Brief for Petitioner, *Jarkesy*, 603 U.S. 109, at 21 (No. 22-859)).

214. *Id.* at 152-53 (Gorsuch, J., concurring) (quoting Brief for Petitioner, *Jarkesy*, 603 U.S. 109, at 24 (No. 22-859)).

215. *Id.* at 152-53 (Gorsuch, J., concurring).

216. *Id.* at 167 (Gorsuch, J., concurring) (quoting Plaut v. Spendthrift Farm, Inc., 514 U.S. 211, 239 (1995)).

217. 598 U.S. 175 (2023). These cases were consolidated at the Supreme Court. *Id.*

218. *Id.* at 195-96.

administrative proceeding, specifically related to challenges under the Appointments Clause. Under *Thunder Basin*, "a court may 'presume that Congress does not intend to limit jurisdiction' if (1) 'a finding of preclusion could foreclose all meaningful judicial review'; (2) 'if the suit is wholly collateral to a statute's review provisions'; and if (3) 'the claims are outside the agency's expertise.'"[219]

Justice Kagan, in her opinion, considered the three *Thunder Basin* factors and determined that "because of the unique nature of Axon's and Cochran's purported injuries, no 'meaningful [judicial] review' was available absent district court jurisdiction."[220] The alleged injury cited by Axon and Cochran was that they were being subjected to "an illegitimate proceeding, led by an illegitimate decisionmaker."[221] After-the-fact appellate review would be unable to provide either Axon or Cochran with an adequate remedy.[222] Justice Kagan concluded that both Axon's and Cochran's claims were "collateral" to the enforcement proceedings they were facing and that the constitutional challenges were outside the agencies' expertise.[223] In his concurring opinion, Justice Thomas focused on the private rights versus public rights doctrine, noting his belief that the private rights the government threatened to take away from Axon and Cochran required "full Article III adjudication."[224]

C. CHALLENGES NOT YET ADDRESSED

The Petitioner's brief in *Jarkesy* laid out three questions for the Supreme Court to answer.[225] Notably, the Court elected to respond to

219. Hill v. SEC, 114 F. Supp. 3d 1297, 1306 (N.D. Ga. 2015) (quoting Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 489 (2010)).

220. *See Leading Case: Federal Jurisdiction and Procedure, Axon Enterprise, Inc. v. FTC*, 137 HARV. L. REV. 340, 343 (2023) (citing *Axon*, 598 U.S. at 188-91).

221. *Axon*, 598 U.S. at 191; Leading Case, *supra* note 220, at 343.

222. Leading Case, *supra* note 220, at 343 (citing *Axon*, 598 U.S. at 191).

223. *Id.* (citing *Axon*, 598 U.S. at 191-95).

224. *Axon*, 598 U.S. at 197-99; Leading Case, *supra* note 220, at 344.

225. Brief for Petitioner, *Jarkesy*, 603 U.S. 109, at (I) (No. 22-859). ("1. Whether statutory provisions that empower the Securities and Exchange Commission (SEC) to initiate and adjudicate administrative enforcement proceedings seeking civil penalties violate the Seventh Amendment. 2. Whether statutory provisions that authorize the SEC to choose to enforce the securities laws through an agency adjudication instead of filing a district court action violate the nondelegation doctrine. 3. Whether Congress violated Article II by granting for-cause removal protection to administrative law judges in agencies whose heads enjoy for-cause removal protection.").

only one of the issues raised on appeal.[226] The two remaining issues that have not yet been addressed include: (1) whether statutory provisions that authorize the SEC to choose to enforce the securities laws through an agency adjudication instead of filing a district court action violate the nondelegation doctrine; and (2) whether Congress violated Article II by granting for-cause removal protection to administrative law judges in agencies whose heads enjoy for-cause removal protection.[227] Notably, the Court also declined to address a similar removal question in *Lucia*,[228] making *Jarkesy* the second time the it has chosen to avoid this issue.

Additionally, other questions remain about the decision in *Jarkesy*. For example, does the ruling apply only to cases involving securities fraud, or could it extend to other securities law violations rooted in common law that might also implicate the Seventh Amendment? If the Commission adopts a more thoughtful and restrained approach to using administrative proceedings, the urgency to answer these questions may diminish. In other words, the fact that the statute authorizes the Commission to use administrative proceedings does not necessitate their use over federal district court options.

V. A NEW DIRECTION: FUTURE VISION FOR ADMINISTRATIVE ADJUDICATION

A. REVISE HOW ALJS AND ADMINISTRATIVE PROCEEDINGS ARE USED BY THE COMMISSION

Currently, there are two different groups within the SEC that are involved in administrative proceedings brought by the Commission: the ALJs and the Adjudications Group.[229] The split in responsibilities can raise questions as to whether administrative proceedings and their outcomes are consistent. Given that the SEC has been subject to many external critiques regarding potential bias against respondents in

226. SEC v. Jarkesy, 603 U.S. 109, 2127-28 (2024).

227. Brief for Petitioner, *supra* note 225, at (I); *Jarkesy*, 603 U.S.at 119-21.

228. Lucia v. SEC, 585 U.S. 237, 251 n.1 (2018).

229. *See About the Office of Administrative Law Judges*, SEC (June 7, 2024), https://www.sec.gov/about/divisions-offices/office-administrative-law-judges/about-office-administrative-law-judges; *Adjudication*, SEC (Aug. 21, 2023), https://www.sec.gov/ogc/adjudication.

administrative proceedings,[230] even if there is limited evidence of such actual bias, the SEC must make efforts to counter concerns over the appearance of bias. There are reforms that can mitigate these concerns.

ALJs can play an important and constructive role at the SEC, providing benefits to market participants and investors through a timely, efficient, and thoughtful process. Due to the repeated nature of types of cases brought before ALJs, they can develop subject matter expertise to adjudications as compared to a federal district court judge who reviews a wide variety of cases.

After *Lucia*, the Commission significantly scaled back its use of ALJs as a result of the litigation.[231] Today, the vast majority of administrative proceedings are instead handled directly by the Commission.[232] In such proceedings, the five members of the Commission are advised by the Adjudication Group. As described on the SEC's website, the Adjudication Group:

> [A]dvises and assists the Commission in issuing opinions in appeals from SEC administrative proceedings and adjudications set for a hearing before the Commission. Commission opinions guide the securities industry on questions of law. Adjudication attorneys review the evidentiary records in these matters, research the relevant substantive and procedural requirements, and advise the Commission on how to resolve these proceedings.[233]

Interested stakeholders should consider whether the current practice is functionally different than the Commission's use of ALJs. There are significant differences in managerial oversight of the process when run through the Adjudications Group versus how the process works when handled by an ALJ. Staff in the Adjudications Group work under the ultimate direction of the Chair. As authorized in Reorganization Plan

---

230. *See generally* Joseph A. Grundfest, *Fair or Foul? SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 85 FORDHAM L. REV. 1143 (2016); Drew Thornley & Justin Blount, *SEC In-House Tribunals: A Call for Reform*, 62 VILL. L. REV. 261 (2017); Gretchen Morgenson, *At the SEC, a Question of Home Court Edge*, N.Y. TIMES (Oct. 6, 2013), https://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html.

231. Stone Washington & Izam Karukappadath, *Political Review of Agency Adjudication and Recommendations for Reform* fig. 1 (Regulatory Studies Ctr., George Washington Univ., Sept. 17, 2024), http://regulatorystudies.columbian.gwu.edu/policy-research-integrity.

232. *Id.*

233. *Adjudication*, SEC, *supra* note 229.

No. 10, the Chair—not the Commissioners—has the responsibility for the executive and administrative functions of the Commission.[234]

Among other responsibilities, the Adjudication Group drafts the opinions of the Commission.[235] Under Reorganization Plan No. 10, the Chair holds authority for determining whether materials from any SEC division or office may be distributed to the other Commissioners.[236] At any given time, there can be quite a few of these sometimes-lengthy opinions circulating at once, and an in-depth review by all of the Commissioners is not always guaranteed.[237] Commissioners may not have an opportunity to provide substantive views during the early stages of discussion when legal theories are under consideration and which may ultimately affect the direction of an opinion.

Because final decisions represent the approval of the Commission, such decisions can carry greater weight than a position taken by Commission staff[238] in a complaint or motion in a litigated action.[239] While individual Commissioners sometimes attempt to influence a final Commission decision either through voicing their intent to not support the action and/or through the drafting and sharing of a proposed dissent statement, the fact that it is done after the opinion has already been circulated is inefficient.

More importantly, the separation of functions requirements does not apply to the Chair or the Commissioners,[240] meaning that the recommendations for enforcement and adjudication outcomes are

234. Reorganization Plan No. 10 of 1950, § 1, 5 U.S.C. app. at 48-49 (2023).

235. *Adjudication*, SEC, *supra* note 229.

236. Reorganization Plan No. 10 of 1950, § 1(a)(2), 5 U.S.C. app. at 49 (2023).

237. Each Commissioner relies on their staff to review and advise on these opinions.

238. *See* Chairman Jay Clayton, Statement Regarding SEC Staff Views (Sept. 13, 2018), available at https://www.sec.gov/newsroom/speeches-statements/statement-clayton-091318.

239. One can imagine that, but for *Lucia*, 585 U.S. 237 (2018), the Commission might have decided to implement its policies and legal interpretations on crypto and digital assets by initiating enforcement actions through administrative proceedings. Such an approach would be another form of regulation by enforcement, but the most significant difference is that the Commission, rather than an Article III judge, would be able to control the outcome. Prior to *Loper Bright*, the views of the Commission in administrative proceedings may have been eligible for *Chevron* deference. *See Loper Bright Enters. v. Raimondo*, 603 U.S. 369, 391-98 (2024) (discussing judicial review of agency action under the Administrative Procedure Act and application of *Chevron* deference to purportedly permissible agency interpretations).

240. *See* 17 C.F.R. § 201.121 (2024).

effectively controlled solely by the Chair. By contrast, the ALJs typically issue their initial decision on their own authority, without pre-approval by the Chair.[241]

Given the concerns raised against the use of ALJs by the SEC in administrative proceedings, one would think that the ultimate control of the Adjudication Group by the Chair would raise similar concerns. For that reason, consideration should be given to making ALJs the primary method for resolving administrative proceedings. [242] However, the relationships of the ALJs should evolve. ALJs should not be kept at arms-length distance from the Commission, which is current practice and isolates the ALJ from any involvement in the Commission's final decision. Instead, the ALJs should be viewed as an extension of the Commission whose role is to assist the Commission in carrying out its adjudicatory responsibilities codified in the federal securities laws.

It should be codified in SEC internal procedures that the ALJs operate under the direction of the Commission as a whole. Because the Division of Enforcement, the largest SEC division,[243] reports directly to the Chair,[244] responsibility for oversight of the ALJs should be given to a non-Chair commissioner. One approach would be to randomly assign one non-Chair commissioner to oversee the ALJ in a specific administrative proceeding. In order to avoid the appearance of conflicts, the Commission should clearly lay out the standard that must be met in order for the Commission to authorize an action, clearly explaining that the standard for authorization is lower than the standard that must be met in order to find that a person actually violated federal securities laws. This additional clarity will remove any suggestion that just because the Commission authorized an action that a person or entity will then be found to have violated the provisions laid out in that action.

---

241. *See* 17 C.F.R. § 201.360(a)(1) (2024).

242. This proposal would not apply to the Adjudications Group's role in handling matters for review from the self-regulatory organizations or from the Public Company Accounting Oversight Board.

243. *FY 2025 Congressional Budget Justification & Annual Performance Plan, FY 2023 Annual Performance Report*, SEC 12 (2024), https://www.sec.gov/files/fy-2025-congressional-budget-justification.pdf. In fiscal year 2023, the Division of Enforcement had 1,512 positions. By comparison, the Division of Examinations had 1,222 positions, the Division of Corporation Finance had 478 positions, the Division of Trading and Markets had 321 positions, and the Division of Investment Management had 249 positions. *Id.*

244. *See 2024 SEC Official Organizational Chart*, SEC (2024), https://www.sec.gov/files/secorg.pdf.

While the process has since changed, SEC ALJs have been historically selected from a list prepared by OPM.[245] Thus, they often do not have prior SEC or securities law experience.[246] ALJs tend to have more experience in serving as a hearing officer in trial-like activities, such as listening to testimony and ruling on evidentiary matters.[247] Recent SEC ALJs have been selected and appointed by the Commission after serving at another federal agency.[248] While this approach has some drawbacks, most notably subject matter expertise in the securities laws, these ALJs can have the advantage of prior experience in weighing evidence and applying law to facts in order to make a reasoned decision.

The SEC should provide proper resources to the ALJs. In fiscal year 2023, there were only 7 full-time staff assigned to the Office of ALJs.[249] The ALJs will need additional resources, some of which can be re-allocated from other areas of the SEC, including the Adjudication Group. Even with such resources, ALJs could be more effective if they can have the benefit of expertise from subject matter specialists throughout the SEC. To the extent necessary, internal arrangements should be set up to "wall off" SEC staff in other divisions, such as Corporation Finance, Trading and Markets, and Investment

245. Admin. Conf. of the U.S., Recommendation 2019-2, *Agency Recruitment and Selection of Administrative Law Judges*, 84 Fed. Reg. 38,930 (Aug. 8, 2019), https://www.acus.gov/document/agency-recruitment-and-selection-administrative-law-judges; *Role of Social Security Administrative Law Judges: Hearing Before the Subcomm. on Cts., Com. & Admin. Law of the H. Comm. on the Judiciary and the Subcomm. on Soc. Sec. of the H. Comm. on Ways & Means*, 112th Cong. 48-49 (2011) (statement of Christine Griffin, Deputy Dir., U.S. Office of Pers. Mgmt.).

246. *See generally Examining Due Process in Administrative Hearings: Hearing Before the Subcomm. on Regulatory Affs. & Fed. Mgmt. of the S. Comm. on Homeland Sec. & Governmental Affs.*, 114th Cong. (2016).

247. *Id.*

248. *See* Press Release, U.S. Sec. & Exchange Comm'n, Dean C. Metry Named Chief Administrative Law Judge at SEC (Dec. 22, 2023), https://www.sec.gov/newsroom/press-releases/2023-259 (noting prior service as an ALJ at the U.S. Department of Health and Human Services, the U.S. Department of Homeland Security, and the Social Security Administration); Press Release, U.S. Sec. & Exchange Comm'n, James E. Grimes Named Chief Administrative Law Judge at SEC (Dec. 17, 2021), https://www.sec.gov/newsroom/press-releases/2021-263 (noting prior service at the U.S. Department of Justice); Press Release, U.S. Sec. & Exchange Comm'n, SEC Announces Arrival of New Administrative Law Judge [Jason S. Patil] (Sept. 22, 2014), https://www.sec.gov/newsroom/press-releases/2014-208 (noting prior service at the U.S. Department of Justice).

249. *FY 2025 Congressional Budget Justification*, *supra* note 243, at 47.

Management, from SEC enforcement efforts so that they can provide such expertise to the ALJs in formulating opinions.

In addition to the above structural changes, any administrative proceeding should be subject to de novo review in U.S. district courts rather than the U.S. courts of appeals, and the "substantial evidence" standard should be changed to "preponderance of the evidence" standard.[250] These changes likely require legislation to implement. However, the U.S. district courts are better suited for de novo review of administrative proceedings than the courts of appeals. Administrative agencies should be held accountable for their decisions and judicial review of their decisions play an important role in the checks and balances needed for the administrative state.

B. FORUM SELECTION BASED ON REMEDIES SOUGHT

In *Jarkesy*, the Supreme Court observed "[w]hen the English began evading American juries by siphoning adjudications to juryless admiralty, vice admiralty, and chancery courts, Americans condemned Parliament for 'subvert[ing] the rights and liberties of the colonists.'"[251] Thus, the framers of the Constitution included the Seventh Amendment in the Bill of Rights, thereby embedding that "right in the Constitution, securing it 'against the passing demands of expediency or convenience.'"[252]

In deciding *Jarkesy*, the Supreme Court concluded that the "public rights" exception to the Seventh Amendment did not apply[253] because the antifraud provisions of the federal securities laws "target the same basic conduct as common law fraud, employ the same terms of art, and operate pursuant to similar legal principles."[254] In reaching its decision,

250. "Substantial evidence" is defined as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." Flannery v. SEC, 810 F.3d 1, 9 (1st Cir. 2015). "Preponderance of the evidence" is defined as "requir[ing] the trier of fact 'to believe that the existence of a fact is more probable than its nonexistence before [they] may find in favor of the party who has the burden to persuade.'" Concrete Pipe & Prod. of Ca., Inc. v. Constr. Laborers Pension Tr. for S. Ca., 508 U.S. 602, 622 (1993) (quoting In re Winship, 397 U.S. 358, 371–372, (1970)).

251. SEC v. Jarkesy, 603 U.S. 109, 121-22 (2024) (alterations in original) (quoting Resolutions of the Stamp Act Congress (1765), *reprinted in* SOURCES OF OUR LIBERTIES 270, 271 (R. Perry & J. Cooper eds. 1959).).

252. *Id.* (quoting Reid v. Covert, 354 U.S. 1, 10 (1957) (plurality opinion)).

253. *Id.* at 119.

254. *Id.* at 134.

the Supreme Court left open the door that "public rights" could be adjudicated in an administrative proceeding. The Court discussed the public rights distinction established in *Atlas Roofing*, referencing the regulations and standards issued under the Occupational Safety and Health Act of 1970 by the Department of Labor.[255] The Supreme Court noted that "these standards bring no common law soil with them" and "[r]ather than reiterate common law terms of art, they instead resembled a detailed building code."[256]

While the antifraud provisions may resemble common law causes of action, many other provisions of the federal securities laws and regulations thereunder may have no such similarity. For example, Section 5 of the Securities Act prohibits the offer or sale of a security without registering with the Commission unless an exemption otherwise applies.[257] Many regulations applicable to SEC-registered broker-dealers, investment advisers, nationally-recognized statistical rating agencies, and others appear more similar to a building code than the common law, such as books and records requirements, capital requirements, and compliance policies and procedures.[258] In the past several years, the SEC has imposed civil penalties in the tens of millions of dollars for "off-channel communications," which included text messages on personal devices of employees that were not preserved as books and records.[259]

Rather than using the distinction between private versus public rights as a determining factor for whether to pursue an administrative proceeding, or continuing to use the 2015 Staff Guidance that lacks meaningful direction, the SEC should consider selecting the forum

255. *Id.* at 136.

256. *Id.*

257. 15 U.S.C. § 77e.

258. *See* Jarkesy v. SEC, No. 22-859, slip op. at 23 (U.S. June 27, 2024) (citing *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 447 (1977) (characterizing administrative regulations as resembling a "detailed building code")).

259. *See e.g.*, Barclays Cap., Exchange Act Release No. 95919, 2022 WL 4545819 (Sept. 27, 2022); Citigroup Glob. Mkts. Inc., Exchange Act Release No. 95920, 2022 WL 4545821 (Sept. 27, 2022); Goldman Sachs & Co., Exchange Act Release No. 95922, 2022 WL 4545825 (Sept. 27, 2022); Credit Suisse Secs. (USA) LLC, Exchange Act Release No. 95926, 2022 WL 4545834 (Sept. 27, 2022); U.S. Bancorp Invs., Inc., Exchange Act Release No. 99505, 2024 WL 517502 (Feb. 9, 2024); LPL Fin. LLC, Exchange Act Release No. 100709, 2024 WL 3816629 (Aug. 14, 2024); TD Secs. (USA) LLC, Exchange Act Release No. 100711, 2024 WL 3816635 (Aug. 14, 2024).

based on remedies.[260] Some remedies are more appropriate for adjudication by the agency, whereas other remedies, regardless of their classification as a public right or a private right,[261] raise constitutional concerns on whether the defendant should have the right to an independent adjudicator.[262]

For example, in the off-channel communications sweep cases involving violations of the books and records rules under the Exchange Act and/or the Advisers Act, an argument can be made that the failure to retain each individual text could be an independent violation.[263] Under that approach, if a broker-dealer or investment adviser was found to have failed to retain 9,500 text messages across its workforce, it could be subject to a penalty of $1.1 billion or higher.[264] Civil monetary

260. The limitations articulated are meant to apply only to contested actions. Injunctions carry collateral consequences that cease-and-desist orders do not. These may include, but are not limited to, the fact that they are required to be disclosed if material in subsequent securities transactions, which could cause the loss of one's livelihood and/or threaten an individual's reputation. Litigants could also be "collaterally estopped from relitigating related issues in subsequent private actions." *See* David M. Weiss, Note, *Reexamining the SEC's Use of Obey-the-Law Injunctions*, 7 U.C. DAVIS BUS. L.J. 239, 250 (Fall 2006). Defendants should be provided the opportunity to settle the charges against them in an administrative proceeding thereby avoiding the issuance of an injunction, even if the monetary sanctions exceed the suggested caps laid out in this article.

261. Given the Court's discussion of *Atlas Roofing* in *Jarkesy*, there may be situations where it is unclear as to whether a specific violation involves a public or private right. *Jarkesy*, 603 U.S. at 134-36. Focusing on the remedies eliminates significant time and expenditure of effort to make that determination for which the Commission may not have particular expertise. *See, e.g.*, Axon Enterprise, Inc. v. FTC, 598 U.S. 175, 186 (2023) (listing whether a claim is "outside the agency's expertise" as one of the three *Thunder Basin* factors which "may preclude district courts from exercising jurisdiction over challenges to federal agency action").

262. *Jarkesy*, 603 U.S. at 140 ("A defendant facing a fraud suit has the right to be tried by a jury of his peers before a neutral adjudicator.").

263. The off-channel communications cases to date have been settled actions and were not heard by the Commission. This example of a case is being used to illustrate how penalties can be calculated in order to obtain extremely high dollar amounts.

264. The maximum amount for a Tier 1 violation under various provisions of the federal securities laws is $118,225. *See* Adjustments to Civil Monetary Penalty Amounts, 90 Fed. Reg. 2767, 2769 (Jan. 13, 2025). If the Commission were to allege that the act or omission involved deliberate or reckless disregard of a regulatory requirement, the Commission could seek a Tier 2 penalty. *See* 15 U.S.C. § 78u–2(b). A Tier 2 violation can result in a civil penalty of up to $591,127. *See* Adjustments to Civil Monetary Penalty Amounts, 90 Fed. Reg. at 2769. In the example above, a Tier 2 civil penalty would result in a total amount around $5.6 billion.

penalties imposed by the federal government in the amounts of billions of dollars or more should raise concerns about whether such sanctions should be heard before the federal courts as opposed to administrative agencies charged with prosecuting such violations.

The Commission should limit the remedies sought in administrative proceedings, particularly with respect to seeking civil monetary penalties.[265] Actions seeking non-monetary remedies, such as the issuance of cease-and-desist orders,[266] orders requiring an accounting,[267] and orders to prohibit a person associated with registered entities from serving as an officer or director,[268] are appropriately handled in administrative proceedings. While there are real-life effects from being subject to such actions, particularly with respect to professional reputation, they do not have the attribute of the Executive Branch deciding to seize property of persons without the oversight of an independent adjudicator. In each of these cases, the defendant, if unsatisfied with the administrative proceeding, will have the ability to appeal to an Article III court.

For similar reasons, the Commission should also use administrative proceedings to issue orders denying the registration of a person as a regulated entity, censuring, placing limitations on the activities, functions, or operations of a regulated entity, and temporary and permanent suspensions[269] as well as to suspend or revoke the registration of a security.[270]

With respect to disgorgement and civil penalties, which are monetary in nature, the Commission should consider limiting the

265. *See* Grundfest, *supra* note 230. Grundfest describes three categories of enforcement cases, the first includes all cases statutorily required to be litigated in the administrative forum as well as all cases for which administrative proceedings are appropriate because of the nature of the question presented and the SEC's specialized experience. *Id.* at 1154. The second category of cases includes those that must be heard in federal court and may not be brought in administrative proceedings except with defendant's consent. *Id.* at 1155. The third category is comprised of cases that fall in neither of the other two categories. *Id.* When a case falls into this third category, Grundfest suggests that a defendant have the right to petition a federal district court for removal at the court's discretion. *Id.*

266. *See, e.g.*, 15 U.S.C. § 78u–3(a).

267. *See, e.g.*, *id.* § 78u–3(e).

268. *See, e.g.*, *id.* § 78u–3(f). Officer and director bars for non-associated persons should be sought in Article III courts.

269. *See, e.g.*, *id.* § 78o.

270. *See, e.g.*, *id.* § 78l(j).

amounts sought in litigated administrative proceedings.[271] By limiting the amount sought, it reduces the potential infringement of constitutional rights. For example, in recent SEC enforcement actions alleging a violation of the registration requirements without any allegation of fraud, the SEC has claimed millions of dollars in proceeds of the offering as ill-gotten gains.[272] Imposing disgorgement without the showing of pecuniary harm to victims has been rejected by one U.S. Court of Appeals.[273] Thus, while the SEC might have the authority to pursue equitable claims internally in an administrative proceeding, the question of whether it should choose that forum as a matter of enforcement discretion is another. [274]

Where civil penalties are permitted in administrative proceedings by Jarkesy, the SEC should have a similar limitation in penalties sought. This situation could occur where the SEC seeks civil penalties involving public rights. To avoid the appearance that the SEC is stacking the odds in its favor, the SEC should not seek claims for disgorgement and civil penalties in an amount that exceeds a single Tier 1 violation.275 This

271. These limitations would not be applicable to settled administrative proceedings. There are times when a defendant may prefer a settled administrative proceeding over a settled injunction proceeding. For example, there may be collateral consequences resulting from a court injunction that do not occur from a cease-and-desist order. Injunctions can trigger follow-on administrative proceedings under Sections 15(b)(4) or 15(b)(6) of the Exchange Act for potential deregistration, bars, or suspensions. A person or entity can also be subject to a statutory disqualification from membership in an SRO or association with an SRO member under Section 3(a)(39)(F) of the Exchange Act as well as potentially being disqualified from the Reg A exemption and not providing exemptions under Rule 504 or 506 of Regulation D.

272. *See, e.g.*, Bitclave PTE LTD, Securities Act Release No. 10788, 2020 WL 2791424 (May 28, 2020) (settlement for violations of Sections 5(a) and 5(c) of the Securities Act, which included disgorgement of $25,500,000); Impact Theory, LLC, Securities Act Release No. 11226, 2023 WL 7108828 (Aug. 28, 2023 (settlement for violations of Sections 5(a) and 5(c) of the Securities Act, which included disgorgement of $5,120,718.27); GTV Media Group, Inc., Securities Act Release No. 10979, 2021 WL 4149064 (Sept. 13, 2021) (settlement for violations of Sections 5(a) and 5(c) of the Securities Act, which included disgorgement of $434,134,141).

273. SEC v. Govil, 86 F.4th 89, 105 (2d Cir. 2023).

274. *See* SEC v. Jarkesy, 603 U.S. 109, 122-23 (2024) (citing Tull v. United States, 481 U.S. 412, 422 (1987) ("courts of equity could order a defendant to return unjustly obtained funds")).

275. There are three tiers of penalties that can be imposed under 15 U.S.C. § 78u–2(b). Tier 1 penalties are the lowest level of penalties in the three-tier system. *Id.* § 78u–2(b)(1). Tier 2 penalties require an act or omission that involved "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." *Id.* §

ceiling would limit the total civil penalty obtainable in an administrative proceeding for most securities law violations to $11,823 for a natural person and $118,225 for any other person.276 A similar ceiling might apply to total disgorgement, excluding prejudgment interest, to the same amount. Therefore, the maximum total amount of monetary remedies that could be sought by the Commission combined as disgorgement and civil penalties would be $23,048 for a natural person and $230,462 for others.277 While such a ceiling is a line-drawing exercise, limiting monetary remedies would potentially ameliorate the concerns raised by critics of administrative proceedings.

CONCLUSION

When joining the Commission, Commissioners and staff take an oath of office that pledges allegiance to the U.S. Constitution, not to the agency or the federal securities laws.[278] In that respect, we are responsible first and foremost to the Constitution and to take all actions under the federal securities laws pursuant to the Constitution. The SEC's administrative proceedings have been accused of falling short on constitutional protections. As a result, the Supreme Court has ruled against the SEC in a couple of recent opinions. The SEC should recognize these concerns and undertake an effort to limit its use of

78u–2(b)(2). Tier 3 penalties, in addition to the requirement established for Tier 2, require that the act or omission "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission." *Id.* § 78u–2(b)(3).

276. Civil penalty amounts are adjusted annually pursuant to the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, Pub. L. 114–74, § 701, 129 Stat. 584, 599–601 (codified at 28 U.S.C. § 2461 note). Current civil penalties are published in the Federal Register. Adjustments to Civil Monetary Penalty Amounts, 90 Fed. Reg. 2767, 2769 (Jan. 13, 2025).

277. These amounts exclude prejudgment interest, which is calculated by a mathematical formula and would increase the actual dollar amounts.

278. *See* 5 U.S.C. § 3331 (requiring an individual, except the President, elected or appointed to an office of honor or profit in the civil service or uniformed services, to take the following oath: "I, AB, do solemnly swear (or affirm) that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservation or purpose of evasion; and that I will well and faithfully discharge the duties of the office on which I am about to enter. So help me God.")

administrative proceedings to matters that are less likely to raise constitutional concerns.