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SEC Critics Appeal To Agency Pride In In-House Court Spat

By **Ed Beeson**

Law360, New York (November 07, 2014, 4:22 PM ET) -- As the U.S. Securities and Exchange Commission plows into litigating more cases in-house, critics including U.S. District Judge Jed Rakoff have hit upon a line of attack they hope will reach the image-conscious agency: Relying too much on its administrative court could hurt the SEC's reputation.

In a speech Wednesday widely critical of the SEC's push to litigate more cases in-house and thus sidestep federal courts, Judge Rakoff said the move might not be good for the agency's reputation for fairness, given the limited rights defendants have in the administrative forum compared with federal court, the prospect of high penalties they face and the agency's spotless track record there over the past year.

This sentiment was echoed Thursday, when former SEC enforcement director William McLucas called it a "mistake" when the current enforcement head said the agency would consider litigating insider trading cases within SEC tribunals. Like Judge Rakoff, he said the agency has to think about what this trend looks like to the broader world.

"When you begin to move litigation generally more in-house, there is a perception issue, fairly or unfairly, that it's a home court," McLucas, who now heads WilmerHale's securities practice, said on a panel at a three-day Practising Law Institute event.

"The one thing the SEC doesn't want to do is erode the respect and perspective that the bar, the industry and the public have: that you get a fair shake," he added. "If you start moving too much litigation in house, you are coloring and affecting that perception in a way that is not good for the agency, in my view."

It was clear Friday, however, that the statements weren't yet moving the SEC. Speaking at the PLI event, Andrew Ceresney, the agency's current enforcement chief, defended the practice of bringing more cases before its own administrative law judges and said it is a streamlined tool that allows for efficient prosecutions before fair-minded fact-finders.

He added that it would be a "mistake" to view the move as in response to recent SEC jury trial losses that have captured headlines.

In fact, the U.S. Commodity Futures Trading Commission is headed in the same direction, the head of its enforcement division, Aitan Goelman, said Friday at the PLI event. He said that even though doing so

would not "earn us gold stars with Judge Rakoff," the agency would bring more cases before its own in-house judges.

“The overwhelming reason for this change is resources,” Goelman continued, before adding that the process will help the CFTC develop its own expertise in its new powers under the Dodd-Frank Act.

In a separate statement issued Thursday to Law360, Ceresney said Congress had authorized the agency to bring proceedings in administrative forums as well as federal district courts, and the U.S. Supreme Court had “long ago” approved the forums’ use to enforce statutes and regulations.

“Administrative proceedings have significant procedural protections, and the agency’s law judges are sophisticated fact finders who hear the evidence and whose conclusions are subject to de novo review by the commission itself and, ultimately, review by the federal Courts of Appeals,” he added.

On Friday, Ceresney said the SEC’s use of administrative proceedings would not supplant its reliance on district courts, to which it has to go for certain remedies and powers. Last year, the agency litigated 57 percent of its cases in district court, compared with 43 percent in an administrative forum.

The SEC’s in-house courts originally were set up to allow the agency to suspend or expel members or officers of national securities exchanges. But over the years the SEC has successfully lobbied Congress to grant it broader authority in the venue, Judge Rakoff noted in his speech at the PLI event. The last such expansion occurred through the Dodd-Frank Act, which gave the courts the power to impose collateral bars and civil fines on respondents, or penalties that the agency had originally had to go to federal court to seek.

Ceresney first raised the prospect of bringing insider trading cases in-house at a forum hosted by K&L Gates LLP over the summer, shortly after the agency had suffered back-to-back losses in a pair of insider trading trials, including one against hedge fund manager Nelson Obus. The SEC also was stung publicly last year when a Texas federal jury rejected its insider trading case against billionaire entrepreneur Mark Cuban.

So far, the agency is making good on the pledge. Since late September, the SEC has brought five insider trading cases in its administrative court, notes Thomas Gorman, partner with Dorsey & Whitney LLP and a former SEC enforcement attorney. Two of these cases are being litigated: one against an investor who allegedly bought securities linked to Herbalife Ltd. on the eve of activist investor William Ackman’s public fight against the company, and the other involving two former Wells Fargo & Co. employees.

At the same time, the SEC has faced increasingly bold resistance to its administrative law powers. The agency is separately being sued by the alleged Herbalife investor and activist investment manager Joseph Stilwell, both of whom have lodged claims over the constitutionality of the forums.

In his speech, Judge Rakoff appealed to the SEC’s sense of pride before laying out his criticism of its practices. Calling the agency “one of the jewels of the federal regulatory regime,” he said he felt comfortable offering his thoughts because he was confident the SEC would at least consider them “and not just reject them out-of-hand in the way a less confident or thoughtful agency might.”

The thrust of Judge Rakoff’s remarks, however, was on his concern that the agency could end up hindering the development of anti-fraud provisions of federal securities laws, particularly around insider trading, which federal courts have been instrumental in establishing.

The development of law is something the SEC should be very mindful of, in part because it's an area that serves its own ends, said James Cox, professor at Duke University School of Law.

“I do believe the SEC has to be sensitive to the benefits of proceeding to court and establishing precedent there,” Cox said. “This adds immensely to the expressive power of the law and hence compliance with the law.”

But it may be the point about perception that resonates the most with the SEC, said Matthew Rossi, a former senior enforcement counsel at the agency who is now a partner with Mayer Brown LLP. “The agency has an interest in its own reputation for fairness,” he said.

Judge Rakoff is in a strong position to be heard by the SEC, Rossi said, particularly given the fact the agency’s lawyers frequently appear before him in the Southern District of New York.

“He’s got a bully pulpit that people listen to,” Rossi said, adding that "there is some track record that the SEC listens to him.” He was referring to the agency’s shift toward requiring admissions of wrongdoing in certain enforcement actions, which came after Judge Rakoff slammed the SEC’s default use of settlements in which respondents neither admit nor deny wrongdoing.

Still, some say they see little chance the SEC will change course at this point, regardless of concerns raised in public commentaries.

Gorman of Dorsey & Whitney said despite the well-reasoned criticisms of the administrative forum, particularly from defendants, the regulator will continue using it until some higher power intervenes.

“That’s sort of the history of the SEC. They keep doing this until somebody stops them,” he said.

--Editing by Kat Laskowski and Edrienne Su.
