ARE THE SEC'S ADMINISTRATIVE LAW JUDGES BIASED? AN EMPIRICAL INVESTIGATION

Urska Velikonja*

Abstract: The Dodd-Frank Act significantly expanded the SEC's enforcement flexibility by authorizing the agency to choose whether to bring an enforcement action in court or in an administrative proceeding. The change has faced strong opposition. Federal courts have enjoined several enforcement actions filed in administrative proceedings for constitutional infirmities, and cases are currently winding their way through the appellate process. But even if any constitutional problems were remedied, controversy would persist. Judges, lawmakers, practitioners, and academics have raised doubts as to whether litigation before administrative law judges ("ALJs") is fair to defendants. In advancing their arguments, they have relied heavily on a series of reports published in the Wall Street Journal purporting to show that the SEC enjoys a home-court advantage in litigation before ALJs.

As documented in this Article, the evidence offered by the Wall Street Journal is deficient and its conclusions unfounded. This Article compiles and analyzes a large dataset of all enforcement actions filed in fiscal years 2007 to 2015. Contrary to the claim advanced by the Wall Street Journal and critics of administrative adjudication, SEC litigation before ALJs remains rare. Although the number of contested actions filed in the administrative forum has increased since Dodd-Frank, this is mostly due to an increase in actions that could have been litigated before ALJs prior to the Dodd-Frank amendment. More significantly, there is no robust correlation between the selected forum and case outcome. Federal district court judges ruled for the SEC and against defendants in 88% of cases, whereas ALJs ruled for the SEC in 90% of cases. This finding does not imply that the type of forum in which the SEC litigates does not matter. Rather, there are significant empirical obstacles to finding any useful results by comparing case outcomes.

* Visiting Professor of Law, Georgetown University Law Center; Associate Professor of Law, Emory University School of Law. I thank Adam Badawi, Carlos Berdejo, Brad Bernthal, Tony Casey, John Coyle, Elisabeth de Fontenay, Cathy Hwang, Darian Ibrahim, Jonathan Nash, Elizabeth Pollman, Andy Vollmer, Yesha Yadav, and Kathryn Zeiler, and participants at the Conference on Empirical Legal Studies at Duke, the Midwest Law and Economics Annual Meeting at Emory University, the Law & Business Workshop at UC Berkeley School of Law, and faculty workshops at the University of Virginia School of Law, UC Hastings School of Law and William & Mary Law School. For research assistance, I thank Emma Elliott and Josh Lewin.

INTRODUCTION

In August 2013, the Securities and Exchange Commission ("SEC") celebrated a confidence-boosting victory after a jury trial of the "Fabulous Fab," Goldman Sachs's trader Fabrice Tourre, who was found liable for defrauding investors in mortgage securities.[1] A series of stinging trial defeats for the SEC followed that victory. First, Mark Cuban prevailed after a much-publicized insider-trading jury trial.[2] Soon afterwards, over the course of four months, the SEC lost at trial again and again.[3] Around the same time, the SEC's then-new Enforcement

1. *See* Justin Baer, Chad Bray & Jean Eaglesham, *'Fab' Trader Liable in Fraud*, WALL ST. J. (Aug. 2, 2013), http://www.wsj.com/articles/SB10001424127887323681904578641843284450004 [https://perma.cc/A98Q-X6XU] (reporting that the victory produced "happiness around the halls" of the SEC).

2. *See* Andrew Harris & Tom Korosec, *SEC Loses as Mark Cuban Triumphs in Insider-Trading Trial*, BLOOMBERG (Oct. 18, 2013, 1:48 AM), http://www.bloomberg.com/news/articles/2013-10-16/billionaire-mark-cuban-found-not-liable-in-sec-lawsuit [https://perma.cc/ED22-R62J].

3. Between December 2, 2013 and January 27, 2014, the SEC lost against eight defendants charged with insider trading and accounting fraud. *See* SEC v. Steffes et al., No. 1:10-cv-6266 (N.D. Ill. Jan. 27, 2014); SEC v. Schvacho, No. 1:12-cv-2557 (N.D. Ga. Jan. 7, 2014); SEC v. Jensen & Tekulve, No. 2:11-cv-5316 (C.D. Cal. Dec. 10, 2013); SEC v. Kovzan, No. 2:11-cv-2017 (D. Kan. Dec. 2, 2013). Between October 2013 and the end of January 2014, the SEC lost at trial against nine of fourteen defendants. One of these cases was appealed and remanded, so, at the end, the SEC's track record for the period may be less grim than initially reported. By contrast, at trials concluded between February 2014 and the end of February 2016, the SEC lost against only three of thirty-five defendants. Data on file with author.

Director announced that the agency would file more enforcement actions in the administrative forum instead of in federal district court.[4] Coming on the heels of trial losses, the change in policy looked like an opportunistic search for a more favorable adjudicator. Contemporaneous news articles and commentary insinuated that the SEC was motivated by "home-court advantage,"[5] and speculated that administrative law judges ("ALJs"), who decide cases filed in the administrative forum, were biased in favor of the agency.[6]

The change in enforcement policy was possible because of a provision included in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[7] Section 929P(a) of the Dodd-Frank Act authorized the SEC to seek fines from any firm or individual in an administrative proceeding.[8] Before the amendment, the SEC could impose fines in administrative proceedings only on registered firms and individuals, such as broker-dealers, investment advisers, and firms that registered securities with the agency.[9] But the SEC had to sue in federal district court to secure fines against non-registered firms and individuals—public companies and executive officers charged with accounting fraud; traders charged with insider trading violations; and those charged with selling unregistered securities, including most Ponzi schemers.[10]

Initially, expanding the jurisdiction of ALJs, who decide cases filed in the administrative forum, did not raise eyebrows.[11] Few recognized the amendment's full potential and the SEC was reluctant to use it.[12] As the SEC started filing more actions in the administrative forum, defendants'

4. Gretchen Morgenson, *At the SEC, a Question of Home-Court Edge*, N.Y. TIMES (Oct. 5, 2013), http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html [https://perma.cc/X8MC-GY63].

5. *Id.*

6. In the alternative, more restrained commentators suggested that even if ALJs were not biased, procedural rules in administrative proceedings disadvantaged respondents. *See* William McLucas & Matthew Martens, *How to Rein in the SEC*, WALL ST. J. (June 2, 2015), http://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747 [https://perma.cc/73CH-GA28].

7. Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

8. *See* Dodd-Frank Act § 929P(a)(1), 124 Stat. at 1862.

9. *See* Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429.

10. *See* discussion *infra* section I.A.

11. *See* discussion *infra* section I.A.

12. *See* discussion *infra* section II.B.

objections and public unease began to mount.[13] They culminated in a front-page report published in the *Wall Street Journal*.[14] The news story, based on an analysis of outcomes in SEC enforcement actions over several years, reported that securities defendants were considerably more likely to lose when the SEC sued them in the administrative forum than when it sued them in court.[15] The story purported to offer empirical validation for the claims that ALJs were biased in favor of the SEC, and accused the SEC of steering weaker cases to the administrative forum.[16]

The news story attracted almost immediate responses by federal judges,[17] practitioners,[18] advocates,[19] academics,[20] and the press.[21] Defendants have cited the reported figures in lawsuits that sought to enjoin SEC enforcement actions filed in the administrative forum, arguing that the administrative forum gave the Enforcement Division "an unfair advantage."[22] One federal judge said that these arguments were "compelling and meritorious,"[23] and another added, quoting the

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13. *See* Urska Velikonja, *Securities Settlements in the Shadows*, 126 YALE L.J. F. 124 (2016); Morgenson, *supra* note 4 (quoting SEC enforcement director Andrew Ceresney as saying that the SEC "will be bringing more administrative proceedings given the recent statutory changes").

14. Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL ST. J. (Oct. 21, 2014), http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590 [https://perma.cc/6WGY-2XS2] (reporting that in fiscal years 2012 and 2013 the SEC prevailed in 90% and 100% of trials before ALJs, respectively, and in 75% and 63% of trials in court, respectively).

15. *Id*.

16. *See id.*

17. *See, e.g.*, Jed. S. Rakoff, Address at the PLI Securities Regulation Institute: Is the S.E.C. Becoming a Law Unto Itself? (Nov. 5, 2014), https://securitiesdiary.files.wordpress.com/2014/11/rakoff-pli-speech.pdf [https://perma.cc/277Q-YF53] [hereinafter Rakoff Address].

18. *See, e.g.*, McLucas & Martens, *supra* note 6.

19. *See, e.g.*, Center for Capital Markets Competitiveness, Comment Letter on Proposed Amendments to the Commission's Rules of Practice—17 CFR Part 201 (Dec. 4, 2015), http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf [https://perma.cc/W6AR-QDJS].

20. Rachel E. Barkow, *Overseeing Agency Enforcement*, 84 GEO. WASH. L. REV. 1129, 1160–61 (2016); Kent Barnett, *Against Administrative Judges*, 49 U.C. DAVIS L. REV. 1643, 1645 (2016); Gideon Mark, *SEC Enforcement Discretion*, 94 TEX. L. REV. 261 (2016); *see also* David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1115, 1158 (2016).

21. *See, e.g.*, Jean Eaglesham, *Federal Judge Rules SEC In-House Judge's Appointment 'Likely Unconstitutional,'* WALL ST. J. (June 8, 2015, 4:50 PM), http://www.wsj.com/articles/federal-judge-rules-sec-in-house-judges-appointment-likely-unconstitutional-1433796161 [https://perma.cc/TG6Q-LBAC]; Jenna Greene, *The SEC's on a Long Winning Streak*, NAT'L L.J. (Jan. 22, 2015), http://www.nationallawjournal.com/id=1202715464297/The-SECs-On-a-Long-Winning-Streak [https://perma.cc/TG6Q-LBAC].

22. Douglas Davison, Matthew Martens, Nicole Rabner, Natalie Rastin & John Valentine, *Litigating with—and at—the SEC*, 48 THE REV. OF SEC. & COMMODITIES REG. 103, 103 (2015).

23. Bebo v. SEC, No. 15-cv-3, 2015 WL 905349, at *2 (E.D. Wis. Mar. 3, 2015).

Wall Street Journal figures, that litigation before ALJs was "unfair to the litigants."[24] The SEC's inspector general has conducted an investigation into whether ALJs are biased.[25] Even academic commentators, who are usually skeptical of news reporting, have taken the news articles at face value and relied on them to support their analysis.[26] Relying on the *Wall Street Journal* reporting, two bills have been introduced in Congress to reduce the perceived procedural and substantive bias in administrative securities enforcement.[27] The SEC, under significant and sustained pressure to change its enforcement practices, recently amended procedural rules that govern litigation before ALJs.[28] Although the amendments to the SEC's Rules of Practice substantially expand defendants' procedural rights in administrative proceedings, the critics of its enforcement program demand more by continuing to invoke the purported disparity in outcomes.[29]

That empirical support would influence the debate about a controversial statute is laudable—assuming that the data are

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24. Rakoff Address, *supra* note 17, at 11.

25. OFFICE OF INSPECTOR GEN., SEC, INTERIM REPORT OF INVESTIGATION CASE # 15-ALJ-0482-I 4 (2015), https://www.sec.gov/oig/reportspubs/ oig-sec-interim-report-investigation-admin-law-judges.pdf [https://perma.cc/KG9L-HX2Q] (finding no evidence of bias).

26. *See, e.g.*, Barkow, *supra* note 20, at 1160–61; Mark, *supra* note 20, at 261–62.

27. In the press release announcing the bill, the proponent of the first bill relied heavily and explicitly on the *Wall Street Journal* reporting to justify the amendments. Peter J. Henning, *SEC Victories Delay Challenge on In-House Judges*, N.Y. TIMES (July 5, 2016), http://www.nytimes.com/2016/07/06/business/dealbook/sec-victories-delay-challenge-on-in-house-judges.html [https://perma.cc/29Z9-MV43]; Press Release, U.S. Congressman Scott Garrett, Garrett Introduces Bill to Restore Due Process Rights for All Americans (Oct. 22, 2015), https://garrett.house.gov/media-center/press-releases/garrett-introduces-bill-to-restore-due-process-rights-for-all-americans [https://perma.cc/V85E-5442] [hereinafter Garrett Press Release].

28. *See* Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212 (July 29, 2016) (to be codified at 17 C.F.R. pt. 201) https://www.sec.gov/rules/final/2016/34-78319.pdf [https://perma.cc/UM2B-TNCU]. Half of the comment letters on the proposed amendments to the SEC's Rules of Practice cited the *Wall Street Journal* news story to contend that securities defendants sued in administrative proceeding "lose substantially more frequently than do defendants in federal court." *See, e.g.*, Susan E. Brune, Brune & Richard LLP, Comment Letter on Proposed Rule on Amendments to the Commission's Rules of Practice (File No. S7-18-15) (Nov. 23, 2015), https://www.sec.gov/comments/s7-18-15/s71815-2.pdf [https://perma.cc/C3AS-8FGK].

29. *See* Bradley J. Bondi, Sara E. Ortiz & Michael Wheatley, *Cahill Discusses SEC's Amendments to Rules of Practice for Administrative Proceedings*, COLUM. L. SCH.: CLS BLUE SKY BLOG (July 21, 2016), http://clsbluesky.law.columbia.edu/2016/07/21/cahill-discusses-secs-amendments-to-rules-of-practice-for-administrative-proceedings/ [https://perma.cc/GG3J-3NZM] ("It remains to be seen whether these amendments will impact the statistical disparity . . . ."); Kimberley A. Strassel, *The SEC Plays Judge and Jury*, WALL ST. J. (Aug. 4, 2016), http://www.wsj.com/articles/the-sec-plays-judge-and-jury-1470353410 [https://perma.cc/5PVD-RG34] (opining that the SEC "loves" to litigate before ALJs because it is more likely to win, citing to the *Wall Street Journal* report).

representative and the analysis thorough and correct. Unfortunately, the evidence that most critics of ALJ adjudication cite is misleading in important respects. This Article is the first to collect and analyze all enforcement actions filed over a relatively long period of time: it reviews enforcement actions filed between fiscal years 2007 and 2015 against 10,967 defendants.[30] Using the collected data, the Article tests two related claims that the *Wall Street Journal* and the critics of administrative adjudication have advanced: first, whether the SEC is steering more contested cases to administrative proceedings, and second, whether the SEC is more likely to prevail in cases decided by ALJs.

As to the first claim, the Article reports evidence that the SEC has been litigating more in administrative proceedings since the adoption the Dodd-Frank Act.[31] Not all of the increase is attributable to expanded jurisdiction of ALJs; about half of the increase is due to the fact that the SEC has recently brought more actions that could have been filed in administrative proceedings even before the Dodd-Frank amendment. As to the second claim, the difference in outcomes is largely the result of the different nature of cases filed in each type of forum. The SEC is considerably less likely to prevail against a defendant sued for insider trading and accounting fraud regardless of forum. These cases are also considerably less likely to be filed in the administrative forum. As a result, a comparison of success rates by venue that does not control for the subject matter of the action will understate the SEC's success in court and overstate its success in the administrative forum. In addition, the news stories to date compared outcomes after trial.[32] But most SEC cases decided by a judge are resolved by summary judgment.[33] After one controls for the subject matter, or once one includes cases decided by dispositive motions and not only after trial, the reported disparity in outcomes disappears.[34] In fact, the only way to reproduce the *Wall Street Journal* win-ratios is to compare outcomes after trial and on motion to

30. The only other serious academic effort to evaluate case outcomes has been made by Professor Grundfest, though with a considerably more limited set of data. *See* Joseph A. Grundfest, *Fair or Foul? SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 85 FORDHAM L. REV. 1143, 1143 (2016).

31. *See* discussion *infra* section II.B.

32. *See, e.g.*, Morgenson, *supra* note 4 (noting that the SEC prevailed in "7.5 out of 12" cases litigated in district court). The SEC prevailed against 59 defendants sued in 2011 (data on file with author), suggesting that the figure reported by the *New York Times* does not include summary judgments. *See also* Grundfest, *supra* note 30, at 1178 (implying that the *Wall Street Journal* reports did not include summary judgments in their analysis).

33. *See infra* Table 3.

34. *See* discussion *infra* section II.C.

dismiss, but exclude cases resoloved by summary judgment. In short, the *Wall Street Journal* compared apples to oranges.

The results reported in this Article are significant because of the substantial influence that the *Wall Street Journal*'s reporting has had and may continue to have on the law and practice of securities enforcement. At the same time, the results reported in this Article should not be understood to imply that the type of forum does not matter in securities enforcement. Rather, the information that is available on enforcement actions does not allow one to draw useful empirical conclusions regarding the relationship between forum choice and case outcome. The controversy surrounding administrative adjudication will no doubt continue after this Article, but hopefully not on the basis of discredited empirical evidence.

This Article proceeds in three parts. Part I describes the legal background of the Dodd-Frank amendment, the difference in procedural rules in court and before ALJs, and the related constitutional and empirical challenges. Part II uses a complete dataset of enforcement actions filed between 2007 and 2015 to assess two claims: first, that the reported increase in the cases filed in administrative proceedings is due largely to contested litigation before ALJs; and second, that ALJs are more likely to rule for the SEC than federal judges. The Article finds only limited support for the first claim and none for the second. Part III discusses the implications of the results. Significantly, because of omitted and unobservable variables, as well as selection bias, the result should not be interpreted to suggest that the forum makes no difference. Rather, the data in this space is not useful to resolve what is at its core a public relations problem for the SEC. It is nevertheless important to correct the record because the *Wall Street Journal*'s study has been so influential since its publication. The Article concludes with a caveat regarding greater use of empirical scholarship in policymaking. As the influence of big data increases, so should our concern about the quality of the data and the analysis. The significant impact of the *Wall Street Journal*'s flawed reporting provides a cautionary tale.

I. LEGAL CHANGE AND THE RELATED CONTROVERSY

This Part sets the stage for the empirical analysis that follows in Part II. It explains the legal background and the significance of the Dodd-Frank amendment, outlines the procedural differences between the two different types of forums, and concludes with a discussion of the constitutional and empirical challenges raised against adjudication by ALJs.

A. The Legal Change

The Dodd-Frank Act included hundreds of new legal provisions. Some of them, like the creation of the Consumer Financial Protection Bureau and the Volcker Rule, attracted considerable political, media, and academic attention at the time they were adopted.[35] Others did not.

Section 929P(a) was one of those sections that few (outside of a small group of securities lawyers) paid attention to at the time. The legislative history for the amendment is remarkably sparse. Robert Khuzami, the SEC's then-Director of Enforcement submitted a ten-page statement to the Senate Judiciary Committee in support of Dodd-Frank, and he devoted a single sentence to what would become section 929P(a): "[a]dditional legislative proposals that would serve to enhance the Division's effectiveness and efficiency include the ability to seek civil penalties in cease-and-desist proceedings."[36] The only legislative history of section 929P(a) in the House Report on Dodd-Frank states that "[t]his section streamlines the SEC's existing enforcement authorities by permitting the SEC to seek civil money penalties in cease-and-desist proceedings under Federal securities laws."[37]

Historically, the SEC could seek to enjoin or to stop violations of securities laws but could not seek monetary sanctions. During the 1970s, the SEC began to seek disgorgement of ill-gotten gain as an ancillary equitable remedy,[38] but it did not have the right to seek fines until 1984.[39] The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 ("Reform Act") expanded the SEC's penalty authority.[40] The Reform Act empowered the SEC to seek fines in administrative proceedings against entities and individuals registered with the SEC, including broker-dealers, investment advisers, and firms that registered

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35. *See, e.g.*, Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES (July 22, 2010), http://www.nytimes.com/2010/07/22/business/22regulate.html [https://perma.cc/Z2YK-WZP2].

36. *Mortgage Fraud, Securities Fraud, and the Financial Meltdown: Prosecuting Those Responsible: Hearing 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 [https://perma.cc/YG4K-4SYL].

37. H.R. REP. No. 111-687, § 211, at 78 (2009), https://www.congress.gov/111/crpt/hrpt687/CRPT-111hrpt687-pt1.pdf [https://perma.cc/GZ5E-CWV5].

38. *See* Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1111–12 (2008).

39. The Insider Trading Sanctions Act of 1984 empowered the SEC to seek civil fines in insider trading cases. *See* Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified as amended at 15 U.S.C. § 78u-l(b)(l)(A)).

40. Pub. L. No. 101-429 (1990).

securities with the agency.[41] But in order to secure fines against non-registered firms and individuals, the SEC had to sue them in court. For example, the SEC sued WorldCom in court for accounting fraud and obtained a $750-million fine;[42] likewise the SEC sued Angelo Mozilo in court for securities fraud and secured the "largest-ever financial penalty against a public company's senior executive."[43]

Section 929P(a) of the Dodd-Frank Act authorizes the SEC to seek civil penalties in an administrative cease-and-desist proceeding against any person who is found to have violated federal securities laws.[44] The new provision allows the SEC to resolve almost any enforcement action in an administrative proceeding, but it does not eliminate the SEC's authority to litigate in court.[45] As a result, the SEC can exercise discretion in choosing where to file any enforcement action,[46] except for actions in which the SEC seeks remedies that only courts or ALJs can impose.[47] When an agency can choose the forum, it will usually litigate where it is more cost-effective to do so.[48]

Considerable procedural differences between adjudication in court and in an administrative proceeding are discussed in more detail below. Respondents—as defendants in administrative proceedings are called—face a time-compressed schedule as compared with litigation in court,

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41. *Id.*

42. Press Release, SEC, The Honorable Jed Rakoff Approves Settlement of SEC's Claim for a Civil Penalty Against WorldCom (July 7, 2003), https://www.sec.gov/news/ press/2003-81.htm [https://perma.cc/6XMG-PGWT].

43. Press Release, SEC, Former Countrywide CEO Angelo Mozilo to Pay SEC's Largest-Ever Financial Penalty Against a Public Company's Senior Executive (Oct. 15, 2010), https://www.sec.gov/news/press/2010/2010-197.htm [https://perma.cc/F5Z6-WK3H].

44. 124 Stat. 1862 (2010). A cease-and-desist proceeding is an administrative proceeding seeking to order the respondent to cease and desist violating securities laws. The court equivalent is an injunctive proceeding in which the SEC seeks an obey-the-law injunction.

45. *See* Dodd-Frank § 929P(a)(1), 124 Stat. at 1862. The section expands the jurisdiction of ALJs without amending other provisions relating to venue.

46. Andrew Ceresney, the former director of the SEC Enforcement Division explained that "Congress provided us authority to obtain penalties in administrative proceedings against unregistered parties comparable to those we already could obtain from registered persons." Andrew Ceresney, Dir., Div. of Enf't, SEC, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/ Speech/1370543515297 [https://perma.cc/V4P6-77ZB] [hereinafter Ceresney, *ABA Remarks*].

47. For example, only a court can order a clawback under section 304 of the Sarbanes-Oxley Act, while an associational or professional bar can be ordered only in administrative proceedings.

48. *See* Andrew Ceresney, Dir., Div. of Enf't, SEC, Keynote Speech at New York City Bar 4th Annual White Collar Institute (May 12, 2015), https://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html [https://perma.cc/97ZV-LYJH]. The SEC is far from the only agency that can seek monetary penalties in an administrative proceeding: so can the FTC, the OSHA, banking regulators, etc.

and they have fewer procedural protections.[49] Different rules have given rise to constitutional objections and, more recently, to empirical claims that respondents are at a disadvantage when forced to defend themselves in administrative proceedings.[50] The following sections discuss these developments in turn.

B. Procedural Differences

The SEC has plenary enforcement authority over violations of federal securities laws.[51] In court, the Commission is authorized to seek monetary penalties, disgorgement, clawbacks, injunctions, officer and director bars, and an assortment of equitable remedies.[52] In an administrative forum, the agency can seek monetary penalties and disgorgement, cease-and-desist orders (which are similar to injunctions), as well as officer and director bars, various bars from working in the securities industry, and bars from appearing before the Commission as auditor or attorney.[53] The overlap in remedies is not perfect, but in most enforcement actions the Commission can "obtain many . . . of the same remedies in administrative proceedings as [it] could get in district court."[54]

An administrative proceeding differs from in-court litigation in several respects. In settled actions filed in the administrative forum, ALJs are not involved at all: the Enforcement Division proposes a settlement and the Commission (i.e., the sitting commissioners) approves the settlement by issuing the order instituting proceedings ("OIP"), making findings, and imposing sanctions.[55] By contrast, settled actions filed in federal district court must be approved first by the Commission and then by a judge in order to become effective.[56]

Procedural rules differ more significantly in contested actions as compared with settled actions, though the difference can easily be

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49. *See* discussion *infra* in section I.B.

50. *See, e.g.*, Morgenson, *supra* note 4; Eaglesham, *supra* note 14.

51. 15 U.S.C. § 77t(a), (b) (2012) ("Whenever it shall appear to the Commission [that] *any rule or regulation* . . . have been or are about to be violated, it . . . may investigate such facts." (emphasis added)).

52. *See* 15 U.S.C. §§ 78u–78u-1 (2012).

53. *Id.* §§ 78u-2–78u-3.

54. Ceresney, *ABA Remarks*, *supra* note 46.

55. *See, e.g.*, Citigroup Global Mkts., Inc., Exchange Act Release No. 78291, 2016 WL 4363820 (July 12, 2016) (order instituting public administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order).

56. *See* Velikonja, *supra* note 13, at 128.

overstated.[57] Formal administrative adjudication at the SEC is governed by the Administrative Procedure Act and the SEC's Rules of Practice.[58] Internal rules provide that ALJs conduct hearings "in a manner similar to non-jury trials in the federal district courts."[59] ALJs receive career appointments, not unlike federal judges.[60] At a high level of generality, proceedings before ALJs are similar to judicial adjudication.[61] The parties have the opportunity to submit briefs and to propose findings of fact and conclusions of law.[62] After a hearing, the ALJ prepares a written decision that can be appealed to the Commission.[63]

But the devil is in the details. A defendant in federal district court has the right to full civil discovery and adjudication by an independent Article III judge, and the procedure is governed by the Federal Rules of Evidence and the Federal Rules of Civil Procedure.[64] A defendant sued in court is usually entitled to a jury trial, though more often than not, the SEC's civil actions are resolved by summary judgment, not by a jury.[65] Judges who preside over cases heard in court are completely independent from the agency. Significantly, judges are also better positioned to dispatch "wholesale rebukes of agencies" and are less constrained by "bureaucratic regularity" than ALJs.[66]

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57. SEC ALJs enjoy many of the powers that trial judges have. 5 U.S.C. §§ 556–57. *But see* Sarah N. Lynch, *SEC to File Some Insider-Trading Cases in Its In-House Court*, REUTERS (June 11, 2014) http://www.reuters.com/article/us-sec-insidertrading-idUSKBN0EM2DI20140611 [https://perma.cc/Y64E-BU6Y] (quoting one defendant's charge that the administrative proceedings at the SEC are a "kangaroo court").

58. 17 C.F.R. § 201 (2012).

59. U.S. SECURITIES AND EXCHANGE COMMISSION, OFFICE OF ADMINISTRATIVE LAW JUDGES (2016), https://www.sec.gov/alj [https://perma.cc/4D82-K2DW].

60. 5 C.F.R. § 930.204(a) (2012). Grounds for removal of ALJs who are civil servants are broader than for federal judges, who can only be removed by impeachment.

61. *See, e.g.*, Fed. Mar. Comm'n v. S.C. State Ports Auth., 535 U.S. 743, 744 (2002) ("[T]he role of the ALJ is similar to that of an Article III judge . . . ."); Butz v. Economou, 438 U.S. 478, 513 (1978) ("[T]he role of the modern . . . administrative law judge . . . is 'functionally comparable' to that of a judge.").

62. *See* 17 C.F.R. § 201.340 (2012).

63. *Id.* § 201.360. Of cases analyzed in this Article, 56 were appealed to the Commission. The Commission affirmed the Initial Decision without changes in 29 cases (52%); it reduced sanctions in 17 cases (30%), including dismissing charges in 3 cases; and it increased sanctions in 10 cases (18%), including finding liability and imposing sanctions in 4 cases that ALJs had dismissed.

64. FED. R. EVID. 1101; FED. R. CIV. P. 1.

65. *See* discussion *infra* section II.B.

66. Zaring, *supra* note 20, at 1217 (using *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), as an example for a broad equitable decision).

By contrast, ALJs are SEC employees. There is no jury. ALJs follow the rules of administrative procedure and have no equitable authority.[67] ALJs can hear "[a]ny oral or documentary evidence"[68] except for evidence that is "irrelevant, immaterial, or unduly repetitious."[69] Hearsay evidence is more easily admissible in proceedings before ALJs than in court.[70] Defendants can submit only a limited number of depositions in litigation before an ALJ; they can submit more depositions in court.[71] Some motions, including motions to dismiss, either were unavailable in administrative proceedings until recently[72] or were available in more limited circumstances than they are in court.[73]

Most significantly, the process before ALJs is much quicker than in court. Mandatory timelines imposed by the SEC's Rules of Practice require that in many cases, the entire administrative proceeding be completed in less than one year.[74] The July 2016 amendments extended the prehearing period from four to up to ten months. Despite the extension, the entire timeline before ALJs remains compressed when compared with court, where the median contested enforcement action takes an extra five months to resolve.[75] The tight timeline in a proceeding before an ALJ can be both a bug and a feature for the

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67. Administrative adjudication is a creature of statute, whereas courts have equitable authority arising from the common law. *See generally* Zaring, *supra* note 20, at 1216 (observing that when reviewing agency actions, courts "apply . . . the procedural requirements of the APA" and not "broad equitable principles").

68. 5 U.S.C. § 556(d) (2012).

69. 17 C.F.R. § 201.320 (2012).

70. Thomas C. Gonnella, Exchange Act Release No. 1579 (July 2, 2014) (order on motions in limine), https://www.sec.gov/alj/aljorders/2014/ap-1579.pdf [https://perma.cc/TC4W-ST47] (providing that "when 'in doubt,'" about the admissibility of evidence, "the evidence should be admitted").

71. *See* Zaring, *supra* note 20, at 1167 n.54 (quoting SEC Director of Enforcement Ceresney as saying that depositions in criminal proceedings are allowed only in "exceptional circumstances").

72. The amendment to the Rules of Practice adopted in July 2016 authorized either party in an administrative proceeding to file a motion to dismiss, a motion for summary disposition, and a motion for a ruling as a matter of law. *See* Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212 (July 29, 2016) (to be codified at 17 C.F.R. pt. 201).

73. *See* Alexander I. Platt, *Unstacking the Deck: Administrative Summary Judgment and Political Control* (forthcoming 2017), http://ssrn.com/abstract=2809199 [https://perma.cc/24MG-LDG5] [hereinafter Platt, *Unstacking the Deck*].

74. 17 C.F.R. § 201.360(a)(2) (2012).

75. The median ALJ decision is handed down 632 days after filing; the median court decision is rendered in 767 days. The difference is somewhat larger at the 75th percentile: 972 days for Initial Decision compared with 1170 days for a court decision. Data on file with author. *See also* Press Release, SEC, SEC Adopts Amendments to Rules of Practice for Administrative Proceedings (July 13, 2016), https://www.sec.gov/news/pressrelease/2016-142.html [https://perma.cc/6J7F-GYZ8].

respondent. On the one hand, it may be difficult for a respondent to review the evidence and prepare a defense within the short timeline.[76] On the other hand, once the enforcement action is filed in an administrative proceeding, the SEC Enforcement Division's trial lawyers face the same tight deadlines.[77] A longer timeline in court gives the defendant more time to prepare a defense, but it also extends the period during which the defendant may not be able to work in the securities industry because of the ongoing proceedings.[78]

There are considerable and important procedural differences between an SEC administrative proceeding and litigation in federal district court, but as informed commentators have observed, "those differences do not always favor the Enforcement Division."[79] It is certainly not obvious that the two sets of procedural rules must or should be identical.[80]

Respondents in administrative proceedings do enjoy a significant advantage over those sued in federal court. The SEC's Rules of Practice impose a *Brady*[81] obligation on the Enforcement Division.[82] The Division must turn over all exculpatory evidence to the respondent before any hearing in administrative proceeding, but there is no comparable obligation to defendants the SEC sues in court.[83]

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76. *See* Davison et al., *supra* note 22, at 107.

77. *See id.* at 108. This is true once the action is filed but perhaps misleading. The Enforcement Division that conducted the investigation is familiar with all the material it collected, while the defendant's lawyer may be familiar with only part of the record from the investigation. *See, e.g.*, Harding Advisory LLC & Wing F. Chau, Securities Act Release No. 10277, Investment Company Act Release No. 32415, 2017 WL 66592 (Jan. 6, 2017).

78. *Cf.* Judy K. Wolf, Initial Decision Release No. 851, 2015 WL 4639230 (Aug. 5, 2015) (noting that once Wells Fargo became aware of the SEC investigation, the respondent was placed on administrative leave, and Wells Fargo subsequently terminated her).

79. Davison et al., *supra* note 22, at 113.

80. The United States Supreme Court noted in the past that the similarities between adjudication in court and before ALJs were "overwhelming." Fed. Mar. Comm'n v. S.C. State Ports Auth., 535 U.S. 743, 759 (2002).

81. Brady v. Maryland, 373 U.S. 83 (1963).

82. See 17 C.F.R. § 201.230(a)(1) (2015) ("[T]he Division of Enforcement shall make available for inspection and copying by any party documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division's recommendation to institute proceedings.").

83. Under the rules of civil discovery, the SEC may be compelled to hand over evidence to the defendant, but only if the defendant requests specific evidence. FED. R. CIV. P. 26(b).

C. Constitutional Challenges

The SEC was initially reluctant to use section 929P(a).[84] One of the first contested enforcement actions filed under the new jurisdictional provision was against Rajat Gupta, a high-profile insider trading respondent.[85] Gupta was one of at least twenty-eight defendants in a sprawling insider-trading investigation into Raj Rajaratnam's hedge fund Galleon Management LP. The SEC sued twenty-seven defendants in court, and one, Gupta, in the administrative forum.[86] Gupta filed a lawsuit against the SEC in federal court seeking to enjoin the pending proceeding before the ALJ.[87] Among other claims, he contended that the proceeding before the ALJ would deprive him of equal protection because similar defendants were sued in court, not before an ALJ.[88] After an exchange of briefs and a denial of the SEC's motion to dismiss,[89] the Enforcement Division moved to dismiss the administrative enforcement action[90] and sued Gupta in court, like other defendants it prosecuted for insider trading.[91]

The SEC has faced additional constitutional challenges in lawsuits seeking to enjoin enforcement actions filed in the administrative forum.[92] Several district courts have ruled that using ALJs to resolve

84. *See* Morgenson, *supra* note 4.

85. Rajat K. Gupta, Securities Act Release No. 9192, Exchange Act Release No. 63995, Investment Company Act Release No. 29590 (Mar. 1, 2011), https://www.sec.gov/litigation/admin/2011/33-9192.pdf [https://perma.cc/N5RH-945F] (order instituting administrative and cease-and-desist proceedings).

86. Complaint at 1–2, Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011), 2011 WL 923951.

87. *Id.* at 1.

88. *See id.* at 6–8.

89. *Gupta*, 796 F. Supp. 2d at 503.

90. Rajat K. Gupta, Securities Act Release No. 9249, Exchange Act Release No. 65037, Investment Company Act Release No. 29745, 2011 WL 3407833 (Aug. 4, 2011) (order dismissing proceedings).

91. Complaint, SEC v. Gupta, No. 1:11-cv-7566, 2013 WL 3784138 (S.D.N.Y. July 17, 2013), 2011 WL 5105859. Gupta may have thought that his chances for an acquittal were better in court, so he rolled the dice and lost. Less than a year after the SEC dismissed the administrative proceeding and filed a lawsuit in court, a jury found Mr. Gupta guilty of insider trading in a parallel criminal action, and in mid-2013, the SEC, too, prevailed against Mr. Gupta in a sweeping summary judgment decision. SEC v. Gupta, No. 1:11-cv-7566, 2013 WL 3784138, at *1–2 (S.D.N.Y. July 17, 2013) (holding in favor of the SEC on all counts on liability and remedies).

92. For an analysis of the constitutional arguments advanced by defendants in SEC enforcement actions, see Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAW. 1, 14 (2015).

contested actions was either unconstitutional[93] or "likely unconstitutional."[94]

The most successful and most commonly advanced claims have been those based on the separation of powers as defined in Article II of the U.S. Constitution, specifically appointment and removal authority.[95] ALJs are not appointed within the meaning of Article II by the Commission as Article II requires for appointments of "inferior officers."[96] Instead, the Commission hires ALJs through a competitive process managed by the U.S. Office of Personnel Management ("OPM").[97] When the Commission seeks to hire a new ALJ, the Chief ALJ obtains a list of eligible candidates from OPM. The OPM sets the evaluation criteria and the SEC's Office of Human Resources makes the ultimate selection based on those criteria.[98]

In addition, ALJs enjoy multiple layers of protection from removal by the President.[99] If ALJs are indeed inferior officers, then a violation of Article II follows almost automatically, unless the United States Supreme Court were to craft an exception.[100] Even if the Supreme Court were to find ALJ appointment unconstitutional under the Appointments Clause, the fix—appointment by the Commission[101]—would not change the procedural rules before ALJs nor the perception of their (un)fairness.

Marginally less successful have been claims that administrative adjudication deprives respondents of the right to trial by jury guaranteed by the Seventh Amendment.[102] The right to a jury trial only applies to "suits at common law."[103] The Supreme Court has held that "when Congress creates new statutory 'public rights,' it may assign their

93. *See* Hill v. SEC, No. 1:15-cv-01801-LLM, 2015 WL 12030508 (N.D. Ga. Aug. 4, 2015); *Gupta*, 796 F. Supp. 2d at 513 (holding that litigation before an ALJ deprived the defendant of equal protection).

94. Jean Eaglesham, *SEC Faces Block on In-House Judge*, WALL ST. J., June 9, 2015, at C1.

95. *See* Platt, *supra* note 92, at 14 (listing eight defendants who raised removal claims).

96. U.S. CONST. art. II, § 2; Free Enterprise Fund v. PCAOB, 561 U.S. 477, 511–12 (2010).

97. 5 U.S.C. § 3105 (2012); 5 C.F.R. § 930.201(f) (2016).

98. 5 C.F.R. § 930.201(e)(2) (2016).

99. *Free Enterprise Fund*, 561 U.S. at 484 (2010) (holding that "multilevel protection from removal is contrary to Article II's vesting of the executive power in the President").

100. *See* Platt, *supra* note 92, at 15 (observing that given the widespread use of ALJs across the federal bureaucracy, a holding of their unconstitutionality would be "potentially transformative"); Zaring, *supra* note 20, at 1195 (explaining that given the importance of impartial administrative adjudication, the Supreme Court would likely find an exception).

101. PHH Corp. v. Consumer Fin. Prot. Bureau, 839 F.3d 1 (D.C. Cir. 2016).

102. "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved . . . ." U.S. CONST. amend. VII.

103. *Id.*

adjudication to an administrative agency . . . without violating the Seventh Amendment."[104] In addition, penalty regimes similar to the SEC's are widely used across the administrative state, suggesting that challengers will either have to explain why SEC ALJ adjudications in particular are bad or risk undermining much of administrative practice.[105]

Finally, defendants have raised objections related to due process and non-delegation, none of which have succeeded, nor are they likely to.[106] Although the process before ALJs is different than the process in the courts, both have passed constitutional muster in like situations.[107]

Lawsuits seeking to enjoin the SEC's administrative proceedings for constitutional infirmities have had mixed success. The D.C. Circuit held that ALJ appointment and removal were consistent with Article II of the U.S. Constitution,[108] while the Tenth Circuit held that they were not.[109] On February 16, 2017, the D.C. Circuit vacated its earlier judgment and granted the securities defendant's petition for rehearing *en banc*.[110] By contrast, the empirical challenge to ALJs has persisted without much questioning.

D. Empirical Challenges

In addition to arguing that ALJ adjudication is unconstitutional, defendants and their counsel have effectively argued that administrative proceedings are unfair.[111] To buttress their claims, they have invariably

104. Atlas Roofing Co. v. OSHA Review Comm'n, 430 U.S. 442, 455 (1977).

105. Platt, *supra* note 92, at 18.

106. *See, e.g.*, Fed. Mar. Comm'n v. S.C. State Ports Auth., 535 U.S. 743, 759 (2002) (holding that the similarities between adjudication before ALJs and before federal district court judges are "overwhelming"); Withrow v. Larkin, 421 U.S. 35, 55–56 (1975) (holding that it did not violate due process for the SEC to both investigate and adjudicate a case); *see also* Zaring, *supra* note 20, at 1197.

107. *See Fed. Mar. Comm'n*, 535 U.S. at 743; *Withrow*, 421 U.S. at 55–56; Zaring, *supra* note 20, at 1197.

108. *See* Raymond J. Lucia Cos. v. SEC, 832 F.3d 277 (D.C. Cir. 2016).

109. *See* David F. Bandimere v. SEC, 844 F.3d 1168 (10th Cir. 2016).

110. Order Granting Petitioner's Petition for Rehearing En Banc, Raymond J. Lucia Cos. v. SEC, 832 F.3d 277 (D.C. Cir. 2016) (No. 1661665).

111. *See* Bondi, Ortiz & Wheatley, *supra* note 29; Olson, *infra* note 122 (concluding that the amendments to the Rules of Practice "fail to provide adequate protection"); Brune, *supra* note 28, at 5 (arguing that more significant procedural changes were necessary because "the Commission is able to stack the deck in its favor by having its cases adjudicated by its own judges").

relied on the *Wall Street Journal* report showing a disparity in success rates.[112]

Two strands of empirical critiques of the SEC's administrative adjudication have been advanced. The first contends that procedural rules in administrative proceedings are so unfair to the respondents that they simply cannot win against the SEC.[113] The second contends that ALJs are biased against respondents because ALJs are SEC employees.[114] Both strands rely on the same empirical data.[115]

Perceptions that administrative proceedings may be biased for either procedural or subjective reasons have been circulating for some time. In October 2013, the *New York Times* published an op-ed that suggested

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112. *See* Amended Complaint, Hill v. SEC, No. 1:15-cv-01801-LLM, 2015 WL 12030508 (N.D. Ga. Aug. 4, 2015) (citing the *Wall Street Journal* article for the proposition that the SEC won in 90% of ALJ proceedings between January 2010 and March 2015); Complaint, Timbervest v. SEC, No. 1:15-cv-02106-LMM, 2015 WL 7597428 (N.D. Ga. Aug. 4, 2015); Complaint, Tilton v. SEC, No. 1:15-cv-2472, 2015 WL 4006165 (S.D.N.Y. June 30, 2015); Jean Eaglesham, *U.S. Chamber of Commerce Criticizes SEC's In-House Court*, WALL ST. J., July 15, 2015, at C3.

113. *See* Eaglesham, *supra* note 14; U.S. CHAMBER OF COMMERCE, CTR. FOR CAPITAL MARKET COMPETITIVENESS, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES, at 15; Joseph Quincy Patterson, *Many Key Issues Still Left Unaddressed in the Securities and Exchange Commission's Attempt to Modernize Its Rules of Practice*, 91 NOTRE DAME L. REV. 1675, 1699 (2016); Ryan Jones, *The Fight Over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 510 (2015); Andrew N. Vollmer, *Four Ways to Improve SEC Enforcement*, 43 SEC. REG. L.J. 333, 336 (2015); William F. Johnson & Amelia R. Medina, *SEC's Administrative Enforcement Intensifies Fairness Debate*, N.Y. L.J. (Nov. 6, 2014), http://www.newyorklawjournal.com/id=1202675574765/SECs-Administrative-Enforcement-Intensifies-Fairness-Debate?slreturn=20160705054020 [https://perma.cc/BU2P-T96U].

114. *See, e.g.*, Jean Eaglesham, *SEC Wins With In-House Judges*, WALL ST. J. (May 7, 2015), http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803 [https://perma.cc/E25Z-EBS5]; Morgenson, *supra* note 4; Erin Fuchs, *SEC "Victim" Mark Cuban Speaks out to Help Guy Who's Being Sued in Georgia*, BUS. INSIDER (Sept. 16, 2015, 11:12 AM), http://www.businessinsider.com/mark-cuban-speaks-out-against-the-secs-in-house-judges-2015-9 [https://perma.cc/4TXF-9GHW]. This is contrary to what experienced securities practitioners believe. *See, e.g.*, Jean Eaglesham, *SEC Ex-Enforcement Chief Calls for Reforms to In-House Judges*, WALL ST. J. (May 12, 2015), http://www.wsj.com/articles/sec-ex-enforcement-chief-calls-for-reformsto-in-house-judges-1431471223 [https://perma.cc/7NCE-BBP9] ("Robert Mahony, who retired as an SEC judge in 2012 after more than 14 years at the agency, told the New York conference the SEC judges were 'absolutely 100% fair [and] straight.'" (alteration in original)); McLucas & Martens, *supra* note 6, at A17 (opining that "there is no evidence that ALJs harbor bias"); Daniel R. Walfish, *The Real Problem with SEC Administrative Proceedings, and How to Fix It*, FORBES (July 20, 2015), http://www.forbes.com/sites/danielfisher/2015/07/20/the-real-problem-with-sec-administrative-proceedings-and-how-to-fix-it/ [https://perma.cc/AFZ8-NRZR] ("My own observations are that the ALJs strive to be fair to all parties . . . .").

115. A third strand, namely that the Commission hears appeals from ALJ initial decisions, has been advanced but is less commonly invoked. Significantly, the Commission rarely rejects an ALJ's decision wholesale—though the same is true for appellate review of district court decisions. For data on outcomes in appeals to the Commission, see *supra* note 63.

disparate success rates between actions decided by ALJs as compared with court.[116] But the data was limited to one year of enforcement actions.

In October 2014, the *Wall Street Journal* published a front-page report on SEC enforcement.[117] The story purported to show that the SEC was substantially more likely to prevail against respondents it sued in administrative proceedings than against respondents it sued in federal district court.[118] The *Wall Street Journal* reported that the SEC "won all six contested administrative hearings [in fiscal year 2014] but only 61%—11 out of 18—[of] federal-court trials."[119] In a subsequent story, the *Wall Street Journal* reported that over a five year period, the SEC prevailed in 90% of cases litigated before ALJs, compared with 69% of cases tried in federal court.[120] Significantly, both stories suggested that the SEC was sending more cases to in-house judges opportunistically, because ALJs were more likely to rule in favor of the SEC.[121]

Unlike previous news stories that relied on limited data, the *Wall Street Journal*'s reporting purported to show a persistent disparity in outcomes over several years. The report has had an unusually widespread impact. Following the *Wall Street Journal* reporting, many respected commentators observed that the lack of procedural protections before ALJs "significantly disadvantages respondents who are charged in the SEC's in-house courts."[122] One prominent judge concluded that SEC administrative proceedings were "arguabl[y] unfair[]," and suggested that difficult securities cases be decided "by neutral federal

116. Morgenson, *supra* note 4 (reporting that the SEC prevailed in 88% of cases filed before ALJs and in 63% of cases filed in court during fiscal year 2011).

117. Eaglesham, *supra* note 14.

118. *See id.*

119. *Id.*

120. Eaglesham, *supra* note 114.

121. *Id.* (reporting that in fiscal years 2012 and 2013 the SEC prevailed in 90% and 100% of trials before ALJs and in 75% and 63% of trials in court).

122. Theodore B. Olson, Gibson Dunn, Comment Letter on Proposed Rule on Amendments to the Commission's Rules of Practice (File No. S7-18-15) (Dec. 4, 2015), https://www.sec.gov/comments/s7-18-15/s71815-8.pdf [https://perma.cc/XR8L-A6DF]. *See also* McLucas & Martens, *supra* note 6, at A17; Jean Eaglesham, *SEC Gives Ground on Judges; Facing Criticism and Challenges, Agency Increases Defendants' Legal Safeguards*, WALL ST. J. (Sept. 24, 2015), http://www.wsj.com/articles/sec-gives-ground-on-judges-1443139425 [https://perma.cc/7BYU-8DT6] (quoting Joel Cohen, a partner at Gibson, Dunn & Crutcher LLP, who successfully defended Nelson Obus in 2014 against the SEC as saying that he would not "have been able to develop the facts that convinced the jury to find in [their] favor" before an ALJ).

courts."[123] Citing the same figures reported by the *Wall Street Journal*, the U.S. Chamber of Commerce released a report in July 2015 in which it suggested that defendants could not obtain a "full, fair, and impartial adjudication" before administrative law judges.[124] Even academic commentary jumped on the bandwagon.[125]

These critiques culminated in two bills that were introduced in Congress. The Due Process Restoration Act, introduced in October 2015, would empower securities defendants to remove enforcement actions to federal court and raise the standard of persuasion before ALJs from "preponderance of the evidence" to "clear and convincing."[126] The second bill, the Financial CHOICE Act, introduced in June 2016, follows the approach of the first bill.[127] In addition, the bill would prohibit the SEC from imposing an officer and director bar in an administrative proceeding,[128] presumably to make filing enforcement actions in the administrative forum less appealing.[129] The bill would also give potential defendants the right "to make an in-person presentation" before the commissioners in advance of filing an enforcement action.[130]

Both bills have lingered in Congress, though the CHOICE Act has been revived in the new Congress.[131] The SEC, under significant and sustained pressure to change its enforcement practices,[132] recently

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123. Rakoff Address, *supra* note 17, at 7 (relying on the *Wall Street Journal* figures in concluding that it is "hardly surprising in these circumstances that the S.E.C. won 100% of its internal administrative hearings in the fiscal year ending September 30, 2014, whereas it won only 61% of its trials in federal court during the same period").

124. Center for Capital Markets Competitiveness, *supra* note 19, at 3.

125. *See, e.g.*, Barkow, *supra* note 20; Barnett, *supra* note 20; Mark, *supra* note 20; Jerry W. Markham, *Regulating the U.S. Treasury Market*, 100 MARQ. L. REV. 185, 225 (2016); Platt, *supra* note 92. The two exceptions are Professors Grundfest and Zaring. Grundfest, *supra* note 30; Zaring, *supra* note 20.

126. *See* Garrett Press Release, *supra* note 27.

127. *See* Financial CHOICE Act of 2016, H.R. 5983, 114th Cong. § 416 (2016), http://financialservices.house.gov/uploadedfiles/choice_act-_discussion_draft.pdf [https://perma.cc/9CJ6-Q6P5].

128. *See id.* § 418.

129. *See* Henning, *supra* note 27.

130. *See* H.R. 5983 § 414. Presumably this would be in addition to the defendant's right to file a Wells Submission in advance of filing the enforcement action. *See* SEC, DIV. ENFORCEMENT, ENFORCEMENT MANUAL 20–22 (2016).

131. *See* Rachel Witkowski & Ryan Tracy, *Republicans Get Ready to Roll Back Dodd-Frank Law*, WALL ST. J. (Feb. 5, 2017), https://www.wsj.com/articles/republicans-are-poised-to-roll-out-their-roll-back-of-dodd-frank-law-1486315341 [https://perma.cc/4XKV-2EHP].

132. Half of the comment letters on the proposed amendments to the SEC's Rules of Practice cited the *Wall Street Journal* news story to contend that securities defendants sued in administrative proceeding "lose substantially more frequently than do defendants in federal court." Brune, *supra*

amended the Rules of Practice that govern litigation before ALJs.[133] The amendments substantially expand respondents' procedural rights in administrative proceedings. In what I have described elsewhere as primary enforcement actions,[134] the new rules give respondents ten months instead of four to prepare a defense[135] and allow respondents to take a limited number of depositions,[136] which previously they were not authorized to do. The amendments give the Enforcement Division and the respondent the right to file dispositive motions that are very similar to the motions available in civil litigation in federal district court.[137] Hearsay evidence continues to be permitted, so long as it is relevant, material, and reliable.[138] Because the amendments "fall short of the procedural safeguards afforded defendants in federal district court," securities defense attorneys remain concerned about the purported "statistical disparity" uncovered by the *Wall Street Journal*.[139]

In addition to revising its Rules of Practice, in May 2015 the SEC explained the criteria its staff would use to determine in which forum it would bring an action.[140] Commentators derided the principles as

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note 28, at 1; David M. Zornow, Skadden, Arps, Slate, Meagher & Flom LLP, Comment Letter on Proposed Rule on Amendments to the Commission's Rules of Practice (File No. S7-18-15) (Dec. 4, 2015), https://www.sec.gov/comments/s7-18-15/s71815-6.pdf [https://perma.cc/5BGX-D2BL]; Richard Foster, Financial Services Roundtable, Comment Letter on Proposed Rule on Amendments to the Commission's Rules of Practice (File No. S7-18-15) (Dec. 4, 2015), https://www.sec.gov/comments/s7-18-15/s71815-7.pdf [https://perma.cc/5BGX-D2BL]; Olson, *supra* note 122; Tom Quaadman, Center for Capital Market Competitiveness, U.S. Chamber of Commerce, Comment Letter on Proposed Rule on Amendments to the Commission's Rules of Practice (File No. S7-18-15) (Dec. 4, 2015), https://www.sec.gov/comments/s7-18-15/s71815-12.pdf [https://perma.cc/W6AR-QDJS].

133. *See* Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212 (July 29, 2016) (to be codified at 17 C.F.R. pt. 201).

134. *See* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 928–29 (2016) (describing primary enforcement actions as actions seeking to establish that the defendant violated securities laws and to impose monetary penalties, injunctions, cease-and-desist orders, and other sanctions).

135. *See* 17 C.F.R. § 201.360(a)(2)(ii) (2012).

136. *See id.* § 201.233(a).

137. *See id.* § 201.250.

138. *See id.* § 201.320(b).

139. *See* Bondi, Ortiz & Wheatley, *supra* note 29; Olson, *supra* note 122 (concluding that the amendments to the Rules of Practice "fail to provide adequate protection"); Brune, *supra* note 28, at 5 (arguing that more significant procedural changes were necessary because "the Commission is able to stack the deck in its favor by having its cases adjudicated by its own judges").

140. SEC, DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS, https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf [https://perma.cc/M33U-SBYT].

incoherent,[141] and they had a point.[142] The SEC has yet to offer more definitive sorting principles.

Finally, and perhaps most significantly, faced with incessant criticism over the perceived disparity in outcomes, the SEC has opted to file more actions in court, despite being authorized to litigate actions in the administrative forum.[143] The shift is significant because actions in court are generally more costly to litigate. For an agency that operates on a limited budget, every dollar spent litigating actions in court that could be litigated more cost-effectively in the administrative forum is a dollar not spent prosecuting another securities violation.[144] The trade-off may be worthwhile if the administrative forum is inappropriate for the case in question,[145] but it is nevertheless a trade-off with associated costs and benefits.

II. CONTESTED ACTIONS IN SECURITIES ENFORCEMENT

The news stories have created a perception that ALJs who adjudicate securities enforcement actions filed in the administrative forum are biased against securities defendants,[146] or, in the alternate, that procedural rules in the administrative forum make it difficult for respondents to defend against charges of securities violations.[147] Moreover, critics have alleged that enforcement staff have taken

141. *See, e.g.*, Peter J. Henning, *Choosing the Battlefield in S.E.C. Cases*, N.Y. TIMES (May 11, 2015), http://www.nytimes.com/2015/05/12/business/dealbook/choosing-the-battlefield-in-sec-cases.html [https://perma.cc/8S9Z-RR56] ("The considerations provided by the enforcement division about when it will recommend proceeding before an administrative judge rather than in federal court shed little light on how the decision will be made."); Patterson, *supra* note 113, at 1688.

142. *See* Grundfest, *supra* note 30, at 1148 (explaining that by litigating before ALJs, the SEC wanted to take control over the interpretation of federal securities laws); SEC, SEC DIVISION OF ENFORCEMENT APPROACH TO FORUM SELECTION IN CONTESTED ACTIONS (2015), https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf [https://perma.cc/M33U-SBYT] (explaining that if a "contested matter is likely to raise unsettled and complex legal issues under the federal securities laws . . . obtaining a Commission decision on such issues, subject to appellate review in the federal courts, may facilitate development of the law").

143. Jean Eaglesham, *SEC Trims Use of In-House Judges*, WALL ST. J., Oct. 12, 2015, at A1 (reporting that the SEC filed only 11% of contested actions before ALJs in the fourth quarter of fiscal year 2015, compared with almost 50% in the second quarter).

144. *Cf.* SEC, DIV. OF ENFORCEMENT, ENFORCEMENT MANUAL 4 (2016).

145. *See, e.g.*, Grundfest, *supra* note 30, at 1186 (proposing a list of factors to decide when litigation before ALJs may be appropriate in securities enforcement actions).

146. *See* Eaglesham, *supra* note 114; Morgenson, *supra* note 4; Fuchs, *supra* note 114. This is contrary to what experienced securities practitioners believe. *See, e.g.*, McLucas & Martens, *supra* note 6, at A17 (opining that "there is no evidence that ALJs harbor bias").

147. *See supra* note 113.

advantage of the built-in bias and have been steering cases to ALJs to increase their likelihood of winning.[148] As a result of the perception created by the news stories, the SEC amended its Rules of Practice and has filed fewer actions in the administrative forum since the controversy emerged.[149]

Given the real and significant impact of the *Wall Street Journal*'s reporting, its data and analysis are worth re-examining. This Part reports the results of an empirical investigation into SEC litigation. Contrary to the allegations advanced in the *Journal*'s report, this Part concludes that available data can neither confirm nor refute the charge that the SEC is more likely to prevail before ALJs *because of* their bias in favor of the SEC or *because of* the differences in procedural rules.

The analyzed data do, however, shed light on two related questions. First, the evidence reported in this Part suggests that the SEC has significantly increased the number of respondents sued in the administrative forum. But, only about half of the increase is attributable to the SEC's exercise of its new power to seek fines against non-registered persons in the administrative forum; the other half could have been filed in the administrative forum before the change.[150] Moreover, resolution of contested actions by ALJs remains the exception: a large majority of contested cases continue to be filed in federal district court.[151]

Second, there is no robust support for the proposition that the SEC is more likely to prevail in like cases before ALJs than in court.[152] The variation in outcomes by type of forum reported by the *Wall Street Journal* is largely explained by the different types of cases that are prosecuted in court and by the fact that individuals, who are more often sued in court than firms, are both more likely to contest the SEC's charges and more likely to prevail when they do so.[153]

The lack of a robust relationship between the type of forum and case outcome reported in this Part is significant because of the widely-accepted assertions to the contrary.[154] As discussed in more detail in Part

148. *See e.g.*, Eaglesham, *supra* note 14.

149. *See* Jean Eaglesham, *SEC Trims Use of In-House Judges*, WALL ST. J. (Oct. 11, 2015), https://www.wsj.com/articles/sec-trims-use-of-in-house-judges-1444611604, [https://perma.cc/25AD-CKN2].

150. *See* discussion *infra* section II.B.

151. *See* discussion *infra* section II.B.

152. *See* Velikonja, *supra* note 134134, at 976 nn.414–16.

153. *See* discussion *infra* section II.C.

154. *See* discussion *supra* section I.D.

III, the conclusions offered here should not be interpreted to imply that the type of forum does not matter. There are significant omitted variable and selection bias effects that cannot be resolved with the information that is available.[155] However, the evidence offered in Part II and the analysis discussed in Part III do suggest that any questions of whether administrative adjudication is fair cannot definitively be resolved with empirical evidence.

A. Data and Methodology

The data reported and studied in this Article was drawn from *Select SEC and Market Data Reports* ("Reports") that the SEC prepares annually and publishes on its website.[156] The Reports include a list of all enforcement actions filed during the fiscal year ("FY"), organized by subject matter and date.[157] According to the Reports, between fiscal years 2007 and 2015, the SEC filed about 650 to 800 enforcement actions against 1400 to 1900 defendants per year.[158]

The Reports list SEC litigation by the legal proceedings filed and not by the defendant.[159] In previous work, I reported that the SEC often targets multiple defendants in a single enforcement action and that the same defendant can be targeted for the same securities violation in two or more enforcement actions.[160] This practice renders the accounting of securities enforcement by the number of enforcement actions filed invalid and unreliable.[161] To remedy the problem, I reviewed each enforcement action listed in the Reports for fiscal years 2007 to 2015 and pulled up the relevant documents in PACER or Bloomberg Law for civil actions and in Westlaw or the SEC's website for administrative proceedings. The documents were reviewed, and the information coded

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155. *See* discussion *infra* section III.A.

156. *See Reports and Publications*, SEC, https://www.sec.gov/reports [https://perma.cc/LW33-TAFQ].

157. *See, e.g.*, SEC, SELECT SEC AND MARKET DATA FISCAL 2015, 4–21 tbl.3 (2015), https://www.sec.gov/reportspubs/select-sec-and-market-data/secstats2015.pdf [https://perma.cc/BHY9-8D7G].

158. The source of this information is the SEC annual reports and Select SEC and Market Data reports. *See Reports and Publications*, SEC (Feb. 3, 2017), https://www.sec.gov/reports?aId=TheSubtype_t1&TheYear=&TheSubtype=Select+SEC+and+Market+Data&TheDivision= [https://perma.cc/8VRH-WZ3H].

159. *See, e.g.*, SEC , SELECT SEC AND MARKET DATA FISCAL 2014, at 3–20 tbls. 2–3 (2015) (reporting aggregate information and a complete list of enforcement actions filed in FY 2014).

160. *See* Velikonja, *supra* note 134, at 933–37.

161. *See id.* at 932–57 (discussing the various reasons that reported SEC enforcement statistics are invalid and unreliable).

and tabulated by defendants, not by enforcement actions.[162] The initial coding excludes actions targeting delinquent filing and contempt proceedings.[163] This yields a set of actions against 10,967 defendants.

In the next step, I excluded certain groups of defendants and actions to ensure that the cases compared are, in fact, comparable. First, the data only include defendants charged with securities violations and do not include relief (or nominal) defendants, whom the SEC targeted because they received ill-gotten gain but did not violate securities laws.[164] Although relief defendants often contest charges that the SEC brings, they are, by definition, not securities violators that the SEC punishes. Moreover, the SEC sues virtually all relief defendants in court.[165] Because their likelihood of prevailing against the SEC is driven by different factors than the success of securities defendants, including them in the analysis would not help to assess whether ALJs were more likely to rule for the SEC than judges. Removing relief defendants reduced the data set to 9967 defendants.

Second, only defendants targeted in primary enforcement actions are included,[166] not respondents in follow-on and secondary actions. A primary enforcement action is one in which the SEC targets a defendant for violating securities laws and seeks an injunction or a cease-and-desist order, and perhaps a fine, disgorgement, and other remedies.[167] Primary enforcement actions are filed in court and in the administrative forum.[168] By contrast, the SEC files follow-on and secondary actions in the

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162. Searches for civil actions were done in Bloomberg Law database (which makes PACER available), and searches for administrative actions were done on the SEC's website and in Westlaw.

163. Delinquent filing actions are filed in administrative proceedings and look very different from other primary actions. Defendants are usually defunct entities, the remedy is revocation of the common stock, and most actions are decided by default. *See* Velikonja, *supra* note 134, at 940–45. Studies of SEC enforcement practices usually exclude delinquent filing actions. *See* STEPHEN CHOI, SARA E. GILLEY & DAVID F. MARCUS, NYU POLLACK CTR. FOR LAW & BUS. AND CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY AGAINST PUBLIC COMPANY DEFENDANTS, FISCAL YEARS 2010–2015, at 11 (2016), http://www.law.nyu.edu/sites/default/files/SEC-Enforcement-Activity-FY2010-FY2015.pdf [https://perma.cc/4EJE-MVNB].

164. *See* Velikonja, *supra* note 134, at 946–47.

165. Data on file with author. *See also* Grundfest, *supra* note 30, at 1145 n.2.

166. The SEC divides enforcement actions into three categories: independent enforcement actions, follow-on actions, and delinquent filing actions. *See* Press Release, Securities and Exchange Commission, SEC Announces Enforcement Results for FY 2015 (Oct. 22, 2015), http://www.sec.gov/news/pressrelease/2015-245.html [https://perma.cc/4NYC-JU3E]. The category independent actions combines what I call primary actions and secondary actions. I have continued to use the different nomenclature to avoid double-counting respondents in secondary actions.

167. *See* Velikonja, *supra* note 134, at 928–29.

168. *See* Velikonja, *supra* note 13, at 130 fig. 1.

administrative forum only.[169] Both types of actions are second (and sometimes third) proceedings against the same respondent for the same violation.[170] Follow-on actions are based on injunctions or convictions issued in earlier proceedings, and so respondents are collaterally estopped from contesting the factual basis of the follow-on action.[171] The SEC *should* win follow-on actions.[172] As a result, the SEC's likelihood of success in a follow-on action is considerably higher than in a primary enforcement action. The SEC files few secondary actions and virtually all are either filed as settled actions or are settled during the proceeding.[173]

The compiled data includes actions against 8021 securities defendants in primary enforcement actions. Of those, 5832 were prosecuted in federal district court and 2189 in the administrative forum. In addition to information on the forum in which the action was filed, I collected information on the identity of the defendant (individual or firm); the type of the violation; when the action was filed and when it was resolved or whether it is still ongoing; what was the method of resolution (i.e., filed as settled, settled, default, trial, summary judgment, dismissal, ongoing); whether the case was accompanied by and/or based on a criminal action; and the outcome.[174] In terms of outcomes, I collected information on

169. *See* Velikonja, *supra* note 134, at 929, 935.

170. A follow-on action is a second enforcement action filed against the same defendants for the same violation. It is based on the first enforcement action in which the defendant was fined and enjoined and seeks to impose a professional or associational bar.

The collected data includes follow-on actions against 1854 defendants and secondary actions against 89 defendants. A subset of follow-on actions is based on a criminal conviction alone, and so the follow-on action is the only proceeding before the SEC. These actions were also excluded. For a detailed methodology, see *id.* at 925–32.

171. This is true whether the case was litigated or resolved by settlement. *See* Richard S. Kern & Charles Wilkins, Initial Decision Release No. 281, 2005 WL 924285 (Apr. 21, 2005), https://www.sec.gov/litigation/aljdec/id281jtk.htm [https://perma.cc/D6QT-JG8Y].

172. Velikonja, *supra* note 134, at 963 (reporting that only defendants whose underlying conviction or injunction was vacated prevailed against the SEC in a contested follow-on action).

173. Secondary actions, sometimes referred to as cease-and-desist actions, are best understood as a concession to the respondent. Instead of filing one action in court seeking a fine and an injunction, the Enforcement Division files two: a civil action seeking monetary penalties and an administrative action seeking a cease-and-desist order. *Id.* at 929. This is a concession to the settling defendant because cease-and-desist orders that are imposed in administrative proceedings generally tend to have less significant consequences than obey-the-law injunctions imposed in court actions. *See id.* at 929–32. Of eighty-nine actions, only six were not settled; of those six, three were decided by default, two were consolidated with actions filed in court, and one was voluntarily dismissed. Data on file with author.

174. For civil actions, I performed docket searches and reviewed relevant documents as available in PACER and Bloomberg Law. For administrative actions, the search was done in the SEC's database of administrative proceedings and in Westlaw.

whether the SEC prevailed on at least one count of liability (decisions in court cases are often bifurcated),[175] whether the finding of liability was based on collateral estoppel by a criminal conviction or plea, and the sanction that was imposed. The coding of outcomes includes all actions that were filed in fiscal years 2007 to 2015 and concluded with a substantive disposition on liability by September 15, 2016.

Table 1 below reports summary statistics on primary enforcement actions filed in fiscal years 2007 to 2015. Both firms and individuals are significantly more likely to be sued in court than before ALJs, but individuals are statistically more likely than firms to be sued in court.[176]

Table 1:
Summary Statistics of Filings and Case Resolutions

	Court	Frequency	AP	Frequency
Filings				
Individuals	3876	77.5%	1122	22.5%
Firms	1952	64.7%	1067	35.3%
Filed Settled Actions				
Individuals	1063	27.4%	771	68.6%
Firms	429	21.9%	865	81.0%

As shown in the summary statistics table, firms are generally more likely to settle during the investigation than are individuals, but less so when the action is filed in court. Only a small minority of enforcement actions are contested to the end and ultimately decided by a dispositive motion or after trial. Of the cases that are not filed as settled, more than half ultimately settle. Of the remainder, most are decided by default or voluntarily dismissed because the defendant died, ceased to exist, could not be served, or some similar reason, and only a sliver are contested to the end and decided by a judge, a jury, or an ALJ.[177]

175. *See* Andrew Ceresney, Dir., SEC Div. of Enf't, Remarks at University of Texas School of Law's Government Enforcement Institute: The SEC's Cooperation Program: Reflections on Five Years of Experience, (May 13, 2015), https://www.sec.gov/news/speech/sec-cooperation-program.html [https://perma.cc/2N2L-SH4M] (describing the use of bifurcated settlements in cases where defendants agree to cooperate with the SEC).

176. The difference is statistically significant at $p<0.01$.

177. *See infra* Table 3 and discussion in section II.C.

B. Has the SEC Shifted Enforcement to the Administrative Forum?

During fiscal years 2013, 2014, 2015 and 2016, the SEC reported filing many more enforcement actions in administrative proceedings than in previous years.[178] According to the Reports, in FY 2012 the SEC filed 63% of enforcement actions against 52% of defendants in administrative proceedings.[179] By FY 2014, the SEC filed 81% of enforcement actions against 70% of defendants in administrative proceedings.[180] A shift on that scale in two years is highly unusual, and it has attracted considerable critical attention.[181]

The increase in the share of enforcement actions filed in the administrative forum is due to several confounding factors. The statistics included in the Reports include delinquent filing actions and follow-on proceedings. Since 2010, the SEC has increased both;[182] both groups of cases have always been filed in the administrative forum.[183] Second, since FY 2013 the SEC has increasingly filed actions that are settled during the investigation in the administrative forum.[184] In FY 2010, before Dodd-Frank's adoption, the SEC filed 32% of settled enforcement actions in the administrative forum.[185] By FY 2015, the SEC filed 83% of settled enforcement actions in the administrative forum.[186] For various reasons, when the matter is settled during the investigation, both the SEC and settling defendants usually prefer to file the settled action in the administrative forum.[187]

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178. *Compare* SEC, SELECT SEC AND MARKET DATA: FISCAL 2010, at 3 tbl.2 (2010), https://www.sec.gov/about/secstats2010.pdf [https://perma.cc/98PX-F22B] (reporting 429 actions filed in administrative proceedings) *with* SEC, SELECT SEC AND MARKET DATA: FISCAL 2014, at 2 tbl.1 (2014), http://www.sec.gov/about/secstats2014.pdf [https://perma.cc/7MSL-RC5A] [hereinafter SEC, FY 2014] (reporting 610 actions filed in administrative proceedings).

179. *See* SEC, SELECT SEC AND MARKET DATA FISCAL 2012, at 3 tbl.2.

180. *See* SEC, FY 2014, *supra* note 178, at 3 tbl.2.

181. *See, e.g.*, Zaring, *supra* note 20, at 1174; Platt, *supra* note 92, at 9 (suggesting that court losses "caused the agency to shift" to administrative adjudication); Michael Dvorak, *SEC Administrative Proceedings and Equal Protection "Class of One" Challenges: Evaluating Concerns About SEC Forum Choices*, 2015 COLUM. BUS. L. REV. 1195 (2015); Eaglesham, *supra* note 114 (quoting former SEC Commissioner Grundfest observing that this is "a fundamental change").

182. *See* Velikonja, *supra* note 134, at 978, 980.

183. In both, the SEC succeeds at much higher rates than in primary enforcement actions, but its success is not generally considered as problematic. As noted above, these actions were not included in the statistical comparison of outcomes reported in section II.C.3.

184. *See* Velikonja, *supra* note 13, at 129.

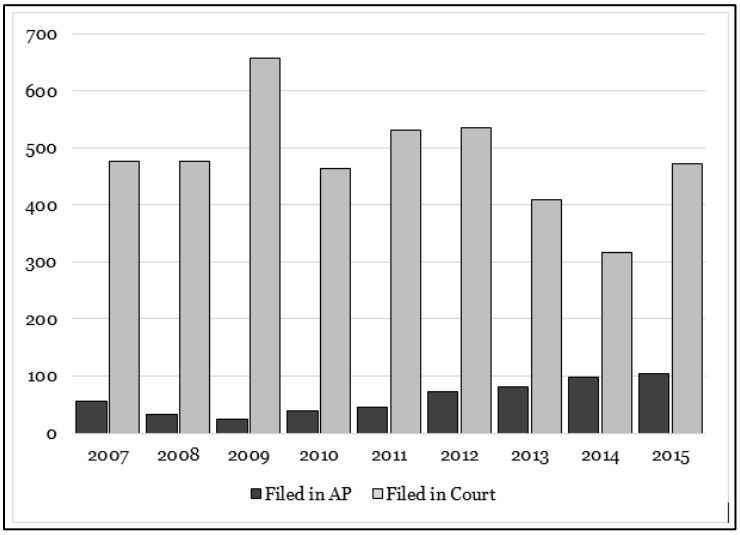
185. *Id*. at 130 fig.1, 137 tbls. 1–3.

186. This is measured by the number of defendants, not actions. *See id*. at 130.

187. *See id.* at 126.

By contrast, the increase in the number and the share of contested actions[188] filed in the administrative forum has been relatively modest. In FY 2010, the fiscal year during which the Dodd-Frank Act became effective, the SEC filed contested enforcement actions against 504 defendants overall.[189] Of these, forty defendants (8%) were sued in the administrative forum and 464 (92%) in court. In FY 2015, the SEC filed contested actions against 577 defendants. Of those, 105 defendants (18%) were sued in the administrative forum and 472 (82%) in court. As shown in Figure 1 below, the change in the number and the share of defendants who are forced to litigate before ALJs is relatively small, but the difference is statistically significant.

Figure 1:
Filings in Contested Cases by Year [190]



The increase in the number of contested case filings in administrative proceedings is not due entirely to the SEC's newly-expanded jurisdiction. A review of all contested orders instituting administrative proceedings between FY 2011 and 2015 reveals that a significant

188. The term "contested action" in this context is meant to include actions that were not filed as settled actions. Many of actions that were initially contested ultimately settled.

189. Data on file with author.

190. The figure reports the number of defendants targeted in contested actions.

majority, 294 of 403, could have been filed in the administrative forum before the statutory change.[191] These include actions against registered investment advisors, broker dealers, and transfer agents for violations of various regulatory and disclosure requirements; they also include stop orders targeting false registered offerings of securities. Thus, about half of the increase in the number of contested actions filed in the administrative forum is attributable to the SEC's exercise of prosecutorial discretion, not to the Dodd-Frank amendment.[192]

However, the other half of contested actions filed in the administrative forum since FY 2011, about 109,[193] were filed pursuant to the SEC's new authority. That number certainly would have been higher absent the controversy about ALJ bias.[194] As suggested by the figures reported in Table 2, the bulk of these cases target securities offering and issuer disclosure and reporting, not insider trading, as some of the commentary has suggested.[195] Most of these cases are still ongoing, so—despite the effort in this Article—it is somewhat premature to examine the SEC's track record in litigation before ALJs after Dodd-Frank.

As a general matter, the SEC has not used expanded jurisdiction of ALJs to advance novel theories of securities violations in contested administrative proceedings, as has been suggested.[196] Most first-of-its-

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191. Data was hand-coded, so the number is best understood as an approximation and not an exact figure.

192. Between FY 2007 and 2010, the SEC sued on average 38.75 respondents in administrative proceedings. Assuming similar trends were to continue, the SEC would sue 194 respondents in administrative proceedings between FY 2011 and 2015. Instead, it sued 403 for an increase of 209 over the pre-Dodd-Frank average. Of those, 100 were defendants who could have been sued in administrative proceedings before Dodd-Frank.

193. The data was hand-coded, so the number is best understood as an approximation and not an exact figure.

194. *See* Eaglesham, *supra* note 143, at A1 (reporting that the SEC filed only 11% of contested actions before ALJs in the fourth quarter of fiscal 2015, compared with almost 50% in the second quarter).

195. *See, e.g.*, Zaring, *supra* note 20, at 1155; Yin Wilczek, *SEC to Pursue More Insider Trading Cases in Administrative Forum, Director Says*, BLOOMBERG BNA (June 13, 2014), http://www.bna.com/sec-pursue-insider-n17179891282/ [https://perma.cc/7TTW-V2Z4]. In fact, only seven defendants who contested charges of insider trading were sued in administrative proceedings between 2011 and 2015.

196. To be fair, the contention is not that the SEC has *often* used ALJs to secure a favorable re-interpretation of the law. Rather, the contention is that the Commission could adopt novel legal intepretations in cases it adjudicates on appeal from an ALJ's initial decision and then demand *Chevron* deference. *See* Andrew N. Vollmer, *SEC Revanchism and the Expansion of Primary Liability Under Section 17(a) and Rule 10b-5*, 10 VA. L. & BUS. REV. 273 (2015) (discussing the SEC's demand for *Chevron* deference to a novel interpretation of securities laws in the SEC's administrative case against Flannery).

kind actions were filed as settled actions, not as contested actions.[197] Instead, as shown in Table 2, the most common charges are similar to the charges that the SEC brings in court: fraudulent disclosure, offering of unregistered securities, and violations related to pooled investment vehicles.

Table 2:
The Number of Defendants Sued in Administrative Proceedings by Subject Matter Category

	2007–10 average	2011	2012	2013	2014	2015
Broker Dealer	13.75	15	27	15	10	11
Investment Adviser	10.75	15	35	34	26	28
Insider Trading	0.5	3	0	0	3	1
Issuer Reporting	3.25	6	3	12	19	13
Market Manipulation	2	2	3	1	0	2
Securities Offering	2.5	5	1	20	37	45
Other	6	1	3	0	2	5
All Contested in APs	38.75	47	72	82	97	105
All Contested in Court	518.75	532	535	409	316	472

In sum, since FY 2011 the SEC has started litigating more aggressively in the administrative forum in both settled and contested actions. The increase is considerable and statistically significant. But the overall number of cases litigated before ALJs remains small compared with the number of cases litigated in court, as shown in Figure 1 above. Moreover, a significant portion of the increase is not attributable to the use of the SEC's new authority to sue non-registered firms and individuals in the administrative forum. Since FY 2011, the SEC has

197. *See* Mary Jo White, Chair, SEC, Chairman's Address at SEC Speaks 2015 (Feb. 20, 2015), http://www.sec.gov/news/speech/2015-spch022015mjw.html [https://perma.cc/B7N6-YUU9].

been aggressive in targeting violations that could have been litigated in the administrative forum before the Dodd-Frank amendment.[198]

In other words, since FY 2011, the SEC has changed the mix of the cases it prosecutes, and many of the contested cases it has litigated before ALJs have been those that can only be prosecuted in the administrative forum. At the same time, the SEC has used its new authority to sue before ALJs more than one hundred defendants that it could have sued only in court before the Dodd-Frank Act. The development is important and one that invites and deserves further study.

C. Is There a Disparity in Outcomes Depending on Where the Enforcement Action Is Filed?

The previous section analyzed changes in filing practices after the Dodd-Frank amendment; this one analyzes case outcomes using the same data. The section begins with an overview of outcomes in SEC enforcement actions. It then defines important variables that are necessary to test the claim that the SEC is more likely to prevail when it litigates before ALJs than in court.

The *Wall Street Journal* report that compared the SEC's success rates in court and before ALJs did not perform any statistical tests of significance.[199] This section uses both a chi-squared test and logistic regression. The chi-squared test compares success rates by venue without controlling for other potentially significant variables. By contrast, in logistic regression, one is able to perform multivariate analysis by controlling for (i.e., holding constant) selected qualities.[200] In other words, logistic regression allows one to test whether the higher likelihood of success before ALJs is due to the type of forum or some other case characteristic. This section uses both statistical methods for a very limited purpose, namely to test whether there is a robust association between the type of forum in which a case is litigated and the outcome.[201]

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198. For example, between 2011 and 2015, the SEC prosecuted thirty-one defendants in stop order proceedings, compared with nine between 2007 and 2010. A stop order proceeding is not settled or contested: it is an action taken ex officio. Data on file with author.

199. *See* Eaglesham, *supra* note 114.

200. *See, e.g.*, David Freeman Engstrom, *The* Twiqbal *Puzzle and Empirical Study of Civil Procedure*, 65 STAN. L. REV. 1203, 1219 (2013) (explaining the differences between a chi-squared test and logistic regression).

201. This Article does not purport to draw any inferences about settled cases and so does not get into the Priest-Klein hypothesis or its critics. *See* Daniel Klerman & Yoon-Ho Alex Lee, *Inferences*

1. Overview of Outcomes in Securities Enforcement

As is true for litigation generally,[202] the vast majority of the SEC's cases ultimately settle. But contrary to the common view, a minority of defendants have settled with the SEC by the time the action is initiated.[203] Of cases filed between fiscal years 2007 and 2015, 3124 of 8021 defendants (39%) settled by the time the SEC filed a public enforcement action. Settlement rates vary from year to year: during the study period, in FY 2009, 32% of defendants settled at initiation; in FY 2014, 48% of defendants did.

As noted, most defendants ultimately settle. More than half of defendants that initially contested the charges settled during the public proceeding, resulting in an overall settlement rate of around 75%.[204] Only a small minority of defendants, 283 of 8021 defendants (3.6%), litigated their cases to trial. For actions resolved by a third-party adjudicator, it is more common that they are decided by default (721 defendants or 9%) or by summary disposition (364 defendants or 4.5%) than by trial.

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from Litigated Cases, 43 J. LEGAL STUD. 209 (2014); George Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984).

202. *See* J. Maria Glover, *The Federal Rules of Civil Settlement*, 87 N.Y.U. L. REV. 1713, 1723 (2012) (observing that "most cases terminate in settlement").

203. Several authors have reported—incorrectly—that the SEC's settlement rate exceeds 90%. *See, e.g.*, Samuel W. Buell, *Liability and Admissions of Wrongdoing in Public Enforcement of Law*, 82 U. CIN. L. REV. 505, 505–06 (2013); Ross MacDonald, *Setting Examples, Not Settling: Toward a New SEC Enforcement Paradigm*, 91 TEX. L. REV. 419, 421 (2012) (stating that the SEC had settled 98% of cases in recent years); David M. Weiss, *Reexamining SEC's Use of Obey-the-Law Injunctions*, 7 U.C. DAVIS BUS. L.J. 239, 239–40 (2006); Roger Parloff, *The Judge Who Slapped Citi*, FORTUNE (Nov. 30, 2011), http://finance.fortune.cnn.com/2011/11/30/judge-jed-rakoff-citigroup-sec/ [https://perma.cc/RW75-AYNC].

204. Of the cases filed in fiscal years 2007 to 2015 and resolved by September 15, 2016, defendants settled in 78% of cases (the denominator to calculate the overall settlement rate does not include ongoing cases).

Table 3:
Case Disposition (2007–15) [205]

	Court	Frequency	Administrative Proceeding	Frequency
Filed Settled	1492	25.6%	1632	74.6%
Settled	2292	39.3%	272	12.3%
Default	636	10.9%	85	3.9%
Dismissal[206]				
Involuntary	29	0.5%	0	0.0%
Voluntary (Def. win)	47	0.8%	1	0.0%
Procedural (no win)	141	2.4%	14	0.6%
Summary Disposition	357	6.2%	7	0.3%
Trial/ALJ[207]	127	2.2%	156	7.1%
Ongoing (i.e., no decision)	711	12.2%	22	1.0%
Total	5832		2189	

In light of the variety in possible case outcomes, one can analyze the SEC's success rate by type of forum in a variety of ways. First, one could look at outcome after trial in court and before ALJs, like the news reports to date have done. The first news story, reported in October 2013, noted that the SEC prevailed in 88% of cases filed before ALJs and in 63% of cases filed in court during FY 2011.[208] The *Wall Street Journal* story, published a year later, reported that between October 2013 and September 2014, "the SEC won all six contested

205. The table includes cases filed in fiscal years 2007 to 2015 and resolved by September 15, 2016.

206. "Involuntary dismissals" are those issued by a third-party adjudicator. "Voluntary dismissals" are those by SEC motion where the case was dismissed because the SEC could not prevail. "Procedural dismissals" are dismissals that were ordered by SEC motion because the case could not continue (e.g., defendant died or dissolved, voluntarily complied, settled another matter), and do not suggest that the defendant prevailed.

207. The category "Trial/ALJ" includes dispositions in 51 cases that are still ongoing but where an ALJ had issued an Initial Decision and the defendant, the Enforcement Division, or both appealed the Initial Decision to the Commission. This was done to test the charge that ALJs, by virtue of being employees of the SEC, are biased in its favor.

208. Morgenson, *supra* note 4.

administrative hearings where verdicts were issued, but only 61%—11 out of 18—federal-court trials."[209] The same article noted that in the preceding two fiscal years, the SEC won 90% and 100% of administrative cases and 70% and 67% of trials in court.[210] In a follow-up story, the *Wall Street Journal* reported that the SEC had been steering cases increasingly to ALJs and prevailed in 90% of cases litigated before ALJs, compared with 69% of cases tried in federal court.[211] The news stories do not explain the methodology used, so the effort to reproduce the newspapers' analyses is a best guess based on the available data.

Table 4 shows the SEC's success rates in cases decided after trial: the SEC prevails in fewer than 83% of jury and bench trials in court but in 89% of cases decided by ALJs.[212] The SEC prevails in over 96% of court cases decided by summary judgment and in 100% of ALJ summary dispositions. The SEC also loses at motion to dismiss in court but not before ALJs. The latter is due to the fact that the motion to dismiss was not available in ALJ litigation until July 2016. Whether one compares success rates after trial or at any stage of litigation, the difference in outcomes in cases filed in court and in administrative forum is much smaller than the one reported by the *Wall Street Journal*, and is not statistically significant.[213]

In fact, the only way to reconstruct the *Wall Street Journal*'s figures—90% success rate before ALJ and 69% success rate in court—is by including trials and involuntary dismissals in the tally, but not summary judgments.[214] But doing that would be a mistake, as any lawyer knows. Summary judgment resolves the case on the merits, just like a trial. Omitting summary judgments also biases the comparison. As reported in Table 4, nearly all summary judgments are issued by courts and not ALJs. The SEC is considerably more likely to prevail in a case decided by summary judgment than it is when the case goes to trial.[215] If

209. Eaglesham, *supra* note 14.

210. *See id.*

211. Eaglesham, *supra* note 114.

212. Prevailing on at least one of the counts is coded as a win by the SEC. This is consistent with the approach adopted by the news stories as well as by the SEC annual reports. *See* discussion *infra* at notes 238–37 and accompanying text.

213. The p-value in a chi-square test is 0.177.

214. Using the numbers in cases resolved after trial and motions to dismiss reported in Table 4, one obtains a 67% success rate in court and 90% before ALJs.

215. The reason that the SEC prevails at summary judgment at such high rates is not bias on the part of federal district judges, it is the fact that many of its enforcement actions are well founded. In addition to defendants who were convicted before the resolution of the summary judgment motion, fifty-five were later convicted or pleaded guilty to securities fraud related to the same set of facts as

one compares success rates in all actions decided by a judge or an ALJ over the SEC's objection, the SEC's success rates are 87.5% in court and 89.6% before an ALJ. The difference is not statistically significant.

Table 4:
Likelihood of Success by Type of Litigation Forum

	Decided in Court	**SEC win**	**Win rate**	**Decided in AP**	**SEC win**	**Win rate**
(1) Trial/ ALJ[216]	127	105	82.7%	156	139	89.1%
(2) Summary Disposition	357	344	96.4%	7	7	100.0%
(3) Involuntary Dismissal	29	0	0.0%	0	0	n. a.
(4) Voluntary Dismissal	47	0	0.0%	1	0	0.0%
Total (1–3)	513	449	87.5%	163	146	89.6%
Total (1–4)	560	449	80.2%	164	146	89.0%

To this one must add two important caveats. First, sometimes the reason that the SEC prevails at summary judgment is that the defendant is fighting a losing battle. In enforcement actions that prosecute offering fraud schemes (e.g., Ponzi, pyramid, and like schemes), penny stock frauds, and insider trading, in particular, the SEC often sues defendants who are facing criminal charges for the same misconduct. As defendants plead guilty or are convicted, the SEC moves for summary judgment on liability in the civil case. In 80 of 344 summary judgments at which the SEC prevailed, the order granting summary judgment for the SEC was based on the defendant's earlier criminal conviction or guilty plea.

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the summary judgment motion. While defendants usually can and do contest the allegations in the SEC's complaint, the fact that they were later criminally sanctioned for the same misconduct goes a long way towards explaining why the SEC is so successful at summary judgment.

It does happen that a defendant prevails against the SEC at summary judgment by lying to the enforcement staff. One such defendant was later indicted for the same violation. *See* Spanish Investor Indicted for Impeding SEC Investigation and Litigation Regarding $4.6 Million Insider Trading Scheme, Litigation Release No. 23591, SEC Docket (CCH) 3634701 (July 5, 2016), https://www.sec.gov/litigation/litreleases/2016/lr23591.htm [https://perma.cc/6ZHD-PEMW].

216. The category "Trial/ALJ" includes dispositions in 51 cases that are still ongoing but where an ALJ had issued an Initial Decision and the defendant, the Enforcement Division, or both appealed the Initial Decision to the Commission. This was done for two reasons: first, to be consistent with the *Wall Street Journal*'s method, and second, to test the charge that ALJs, by virtue of being employees of the SEC, are biased in its favor.

Because convicted defendants are collaterally estopped from denying the allegations related to the criminal charges in the SEC enforcement action, the court usually grants the SEC's request for summary judgment.[217] Excluding these summary judgments from the comparison of success rates lowers the SEC's success rate in court to 369 of 433, or 85%—only marginally lower than the SEC's 90% success rate in the administrative forum and not statistically significant.

Second, not all dismissals are created equal. Enforcement actions are rarely resolved by a contested motion to dismiss. If a case is dismissed, it is usually because the statute of limitations has run,[218] or because the court has no personal jurisdiction over the defendant.[219] Vacatur, an order setting aside a judgment or vacating the legal proceeding, is similarly rare; lower court dispositions or settlements are vacated either when a higher court reverses the district or appellate court's judgment, as occurred in the Supreme Court's decision in *Gabelli v. SEC*,[220] or when a higher court reverses a related decision, as occurred after the Second Circuit decided the *United States v. Newman* insider-trading case.[221] After *Newman*, district courts vacated settlements and summary judgment decisions rendered against ten defendants in SEC enforcement actions, and they may vacate more.[222] These dismissals are included in Tables 3 and 4 as involuntary dismissals against the SEC (i.e., as defendant "wins" by involuntary dismissal).

Despite a handful of highly-publicized involuntary dismissals, a large majority of dismissals are voluntary.[223] The SEC may file a motion to dismiss the action without prejudice and without cost (i.e., each side bears its litigation expenses) for a variety of reasons. More often than not, a voluntary dismissal does not imply that the SEC lost. The SEC routinely moves to dismiss an action against a defendant who died

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217. Courts grant the SEC's summary judgment motions on liability, leaving the only remaining question, on appropriate remedies, for further proceedings. More often than not, the court imposes an injunction and associational bar, but waives or gives credit for fines, forfeiture, and restitution ordered in the criminal case.

218. SEC v. Graham, 21 F. Supp. 3d 1300 (S.D. Fla. 2014). The decision was recently in part reversed on appeal. *See* SEC v. Graham, 823 F.3d 1357 (11th Cir. 2016).

219. SEC v. Sharef, 924 F.Supp.2d 539 (S.D.N.Y. 2013).

220. __ U.S. __, 133 S. Ct. 1216 (2013).

221. United States v. Newman, 773 F.3d 438 (2d Cir. 2014).

222. *See* Ed Beeson, *Newman's Domino Effect: 12 Cases on Edge After Cert. Denial*, LAW360 (Oct. 13, 2015, 9:34 PM), http://www.law360.com/articles/713046/newman-s-domino-effect-12-cases-on-edge-after-cert-denial [https://perma.cc/7W77-74YJ].

223. Details on dismissals are shown *supra* Table 3.

during the proceeding or ceased operations.[224] These dismissals are neither wins nor losses for the SEC, and they are categorized as neither.[225] Voluntary dismissals and postponements for failure to locate and/or serve the defendant because he fled to Tonga[226] or Argentina,[227] likewise, are neither wins nor losses for the SEC, even if the defendant ultimately escapes liability. Similarly, actions that the SEC drops because the defendant was convicted,[228] settled a related enforcement action,[229] or complied with the SEC's demand voluntarily[230] should not count as losses for the SEC. Finally, when the SEC closes a receivership in court, it often voluntarily dismisses enforcement actions against entities after prevailing against the individual who used the entity to perpetrate his scheme. These dismissals are essentially "wins" for the SEC, rather than "losses," but were nonetheless excluded from the analysis.[231]

At the same time, at least some of the voluntary dismissals should be understood as acknowledgements by the Enforcement Division that the case is unwinnable. For example, the SEC sometimes amends the complaint and drops a defendant from the complaint without explanation.[232] At other times, the SEC files a settled motion to dismiss the action without prejudice and without cost. While the motion usually does not explain the reason, news articles and press releases published contemporaneously often explain that the SEC dismissed the action

224. *See, e.g.*, LPB Capital & Gary J. Pappas, Exchange Act Release No. 69885, 2013 WL 3271085 (June 28, 2013) (dismissing the proceeding in light of Pappas' death, LPB Capital's request to terminate investment adviser registration, and inability to pay disgorgement or penalties).

225. That is, they are excluded from the analysis of contested actions.

226. Christopher A.T. Pedras, Admin. Proc. Rulings No. 3773 (ALJ Apr. 8, 2016) (postponement order) https://www.sec.gov/alj/aljorders/2016/ap-3773.pdf [https://perma.cc/QLJ4-SNSG].

227. Notice of Voluntary Dismissal, SEC v. Walters, No. 1:09-cv-337 (D. Colo. May 14, 2015).

228. Order for Judgment, SEC v. Shields & Geodynamics, Inc., No. 1:11-cv-2121 (D. Colo. Mar. 16, 2015).

229. John Briner, Securities Act Release No. 9921, Exchange Act Release No. 75951, 2015 WL 5472562 (Sept. 18, 2015) (order dismissing Chris Whetman, CPA from proceeding).

230. Registration Statement of Sahas Technologies LLC, Securities Act Release No. 9189, 2011 WL 553599 (Feb. 17, 2011).

231. If they were coded as "wins," they would be included in the *Expanded* model below. This would increase the SEC's success rate in court and would render the predictor ALJ no longer statistically significant. *See infra* section II.C.3 and Table 6.

232. *See* Amended Complaint, SEC v. Aragon Capital Advisors LLC, No. 1:07-cv-919 (S.D.N.Y. Mar. 22, 2007) (listing Noga Delshad as defendant); Second Amended Complaint, *Aragon*, No. 1:07-cv-919 (S.D.N.Y. Nov. 12, 2010) (dropping Noga Delshad from the list of defendants).

because it could not advance a successful case.[233] Voluntary dismissals that should properly be understood as SEC "losses" are most common in insider trading actions, and they were included in some of the analyses of case outcomes reported below.

Overall, 232 cases against defendants sued between 2007 and 2015 were dismissed. I reviewed all 232 cases. In addition, I searched for accompanying news stories to find a reason for the dismissal. The actions were hand coded for whether the dismissal was by SEC motion or whether the SEC objected to the dismissal (i.e., voluntary or involuntary): 29 dismissals were involuntary[234] and 203 voluntary. Voluntary dismissals were further coded for whether voluntary dismissal was best understood as a "win" by the defendant. In 155 of 203 voluntary dismissals neither side prevailed, and the case was dismissed due to death, voluntary compliance, or other external circumstances. In 48 of 203 voluntary dismissals, either contemporaneous SEC filings, press releases or news reports indicated that the SEC moved to dismiss the case because it did not believe it could prevail, or there was no information; these cases were coded as defendant "wins."[235] If all 48 voluntary dismissals coded as defendant wins are included in the comparison, the SEC prevailed against 449 of 560 defendants in court (80% success rate) and against 146 of 164 defendants in administrative proceedings (89% success rate). Unlike all other reported differences in success rates, this difference is statistically significant.[236] This result does not imply that ALJs are biased in favor of the SEC; it merely suggests that a defendant sued in court might fare better, in part because the SEC is more likely to dismiss the action voluntarily.

But even this conclusion is premature. The analysis thus far does not account for any case or defendant characteristics that could explain the difference in success rates. The section does suggest, however, that a comparison of outcomes is more complicated than suggested by the *Wall Street Journal* and that the numbers the newspapers have reported are not credible.

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233. Such voluntary dismissals are celebrated in the press as SEC losses. *See, e.g.*, James B. Stewart, *Another Fumble by the S.E.C. on Fraud*, N.Y. TIMES, Nov. 17, 2012, at B1 (reporting that the SEC, "in a rare public about-face," asked a judge to dismiss charges against a defendant).

234. These include insider trading actions that were originally settled or decided by summary judgment but were vacated post-*Newman*.

235. All told, about 20 cases had no information that would help with coding. All were coded as defendant wins, but regressions in section II.C.3 report the results separately, with these 20 cases coded as defendant wins and excluding them from the model as neutral voluntary dismissals.

236. The chi-square statistic is 5.6706; the p-value is .01725. This result is significant at $p<0.05$. The result is the same if summary judgments based on criminal convictions are excluded.

2. Description of the Variables

Comparisons to this point do not control for anything other than where the case is litigated and whether it is based on a prior conviction. But commentators as well as SEC representatives have pointed out that cases vary significantly along other dimensions.[237] For example, many of the SEC's losses at trial have been in insider trading cases. To test the hypothesis that the type of forum matters, I used logistic regression, in which I controlled for case and defendant characteristics. This section provides more detail on how the response variable was constructed and what predictors in addition to the type of forum were used in the regressions reported in section II.C.3. Part III discusses the limitations of the model, in particular the inability to control for case quality, and discusses the implications of the results in light of that limitation.

a. The Response Variable: What Counts as "Success"?

The SEC itself measures success as the percentage of defendants in enforcement actions against which the SEC prevails on at least one of the counts.[238] Alternately, success can be defined more narrowly to record as SEC wins only those cases where the SEC prevails on the most serious charges, such as violations of scienter-based provisions of securities laws,[239] or even more narrowly to record as successes only those cases where the SEC receives all of the relief it seeks.[240] This Article adopts the SEC's own definition of success. It does so because it is the definition adopted in the news stories that have reported on the SEC's success rates and the primary purpose of the study is to question the analysis using the same data.

b. Predictors of Success

The comparisons of success rates reported in section II.C.1 compare outcomes by type of forum without controlling for any other aspects of case quality. But factors other than the forum the case is filed in likely affect the SEC's likelihood of success. The logistic regression analysis

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237. *See* Grundfest, *supra* note 30, at 1175–84.

238. *See, e.g.*, SEC, FY 2010 PERFORMANCE AND ACCOUNTABILITY REPORT 27 (2010), https://www.sec.gov/about/secpar/secpar2010.pdf [https://perma.cc/K674-G688] (reporting that the SEC prevailed in 92% of enforcement actions resolved in FY 2010).

239. Under that definition of success, cases where the SEC prevails only on the subsidiary, negligence-based, or strict-liability counts would count as losses for the SEC.

240. *See* Zaring, *supra* note 20, at 1176.

reported in section II.C.3 includes four independent variables that were expected to be significant predictors[241] of the likelihood of success: the type of forum in which the action is filed, whether the defendant is a firm or an individual, whether the action is accompanied by and/or based on a criminal conviction or plea, and the subject matter category of the enforcement action. I also collected information on the year in which the actions were filed and resolved and on who was SEC Chair at the time the action was filed, but these were not significant predictors of success and so were not included in the regression analyses reported below.

This section provides additional detail on why I selected the predictors included in the regression and how I collected the relevant information. First, this Article tests the *Wall Street Journal*'s claim that the forum in which the case is filed is significantly correlated with the likelihood of success, so that variable was included in all regressions.

Second, as suggested by information included in Table 1, individuals are significantly more likely than firms to contest an enforcement action. The reasons vary but one important reason is that individuals are much more likely than firms to face significant bars and collateral consequences that result from a finding of liability.[242] Because individuals are more likely to contest charges, one would expect outcomes in cases against individuals to be different than outcomes in cases against firms.

Third, where the SEC's case accompanies a criminal action for the same violation, that violation is likely more serious and the SEC's odds of winning higher than when the SEC prosecutes alone. For existence of parallel criminal proceedings, I searched in Bloomberg Law for criminal actions against the defendant, and I reviewed indictments or criminal information documents for facts matching those in the SEC enforcement action. To code for whether the disposition in the SEC's case was based on a parallel criminal case, I read the SEC's dispositive motion (usually the motion for summary judgment) and the court opinion or memorandum explaining the decision granting the SEC's motion. If the opinion mentioned that the defendant was collaterally estopped from disputing the facts, the case was coded as "based on" a criminal action.

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241. In the older literature on statistics, the term independent variable is commonly used to refer to inputs that have some influence on the output or response variable. In the modern statistical literature, independent variables are called predictors, the term this paper adopts. *See* TREVOR HASTIE, ROBERT TIBSHIRANI & JEROME FRIEDMAN, THE ELEMENTS OF STATISTICAL LEARNING: DATA MINING, INFERENCE, AND PREDICTION 9 (2d ed. 2009).

242. *See* Urska Velikonja, *Waiving Disqualification: When Do Securities Violators Receive a Reprieve?*, 103 CALIF. L. REV. 1081, 1112 (2015) (reporting that individuals almost never receive waivers from automatic disqualification provisions).

Finally, I included the subject matter categorization because the likelihood that the SEC will prevail varies significantly by the type of violation charged. *Ceteris paribus*, the SEC should be much more likely to prevail when the violation does not require a showing of mens rea (i.e., strict liability violations) than where the SEC must prove scienter. Many rules in the regulated securities industry are strict liability provisions, so one would expect the SEC's success rate to be higher in actions against broker-dealers and investment advisers, for example, than in actions targeting insider trading. Case categorization is thus expected to be an important predictor of SEC success on the merits.

To code for subject matter category, I used the SEC's Reports for initial coding of subject matter. I coded cases in one of the six categories: securities offering, market manipulation, broker dealer, investment adviser, issuer reporting, and insider trading. Eight cases were coded as "other" because the SEC categorized them as other categories and there were not enough cases in each of the categories to yield meaningful results.[243] Because the SEC categorizes inconsistently,[244] I reviewed all enforcement actions and recoded a handful that were improperly categorized.[245]

Table 5 below reports the SEC's success by type of forum and subject matter category for the dataset labeled as *Substantive Disposition* in regressions reported in section II.C.3. The data includes dispositions by a third-party adjudicator after trial, on motion for summary judgment or summary disposition, and after a defendant's motion to dismiss filed over the SEC's objection. Table 5 does not include voluntary dismissals.[246] The Table suggests that the SEC's overall success rate is marginally greater before ALJs than in court but the difference is not statistically significant. What really makes a difference in the likelihood of success is the subject matter of the charged violation.[247] The SEC loses more than 40% of contested insider trading actions and almost

243. Three cases involve transfer agents, two are miscellaneous, two involve municipal offering, and one involves the FCPA. In a separate set of regressions, I coded these eight cases for the categories to which they were closest. For example, as the SEC used to do in years past, I coded the FCPA case as an issuer disclosure case and the three transfer agent cases as investment adviser cases. I then re-ran all regressions and the results were essentially the same.

244. *See* Velikonja, *supra* note 134, at 954–57.

245. All stop orders were categorized as "Securities Offering." All 12(j) actions were coded as "Delinquent Filing" and excluded from the analysis. Contempt proceedings were coded as such and excluded from the analysis. In all, four contested actions were recoded or removed from the sample.

246. A table of success rates by case category that includes voluntary dismissals by SEC motion is included in the Appendix.

247. As noted above in section II.C.3.a, the difference is statistically significant.

30% of contested accounting fraud actions, but less than 10% of other actions. Since insider trading and accounting fraud cases are overwhelmingly filed in court, the SEC's track record in court looks worse than its record before ALJs.

Table 5:
Summary of SEC Success by Case Category[248]

	SEC win	Number and win rate by category				Total	Overall SEC win rate
		Court	SEC win %	AP	SEC win %		
Overall[249]	Yes	452	87.8%	150	89.8%	602	88.3%
	No	63		17		80	
Issuer Reporting	Yes	35	68.6%	14	77.8%	49	71.0%
	No	16		4		20	
Broker-Dealer	Yes	23	95.8%	53	88.3%	76	90.5%
	No	1		7		8	
Investment Adviser	Yes	54	94.7%	47	90.4%	101	92.7%
	No	3		5		8	
Market Manipulation	Yes	54	94.7%	3	100%	57	95.0%
	No	3		0		3	
Securities Offering	Yes	246	95.3%	21	100%	267	95.7%
	No	12		0		12	

The cases decided by district court judges and ALJs were otherwise similar along several dimensions. The median fine against a firm was zero in both venues and the median fine against an individual was around $200,000. Average fines and fines at the 75th percentile were larger in court, pushed up by securities offering cases.[250] Almost 80% of cases resolved by a judge found the defendant to have violated scienter-based provisions of securities laws; fewer than 50% of cases before ALJs found the defendant to have violated scienter-based provisions of

248. Table 5 reports outcomes in cases decided by a judge (or jury) or an ALJ at any stage. It includes cases decided after a trial, by summary judgment or dismissal over the SEC's objection. As noted above in section II.C.3.a, the difference is not statistically significant.

249. The Overall numbers include three transfer agent actions filed in AP, two municipal securities actions filed in court, one miscellaneous action filed in court and one in AP, and one FCPA action filed in court.

250. The Table includes dispositions at the motion to dismiss (not by consent), summary judgment, and trial stages (i.e., the same as Substantive Disposition dataset in Part II.C.3). The Table includes all actions filed in FY 2007–15 and resolved by September 15, 2016.

securities laws. On the other hand, almost 80% of defendants sued before ALJs were barred from the securities industry or from practicing before the Commission, whereas fewer than half of defendants sued in court were ultimately barred.[251]

3. Regression Results

Using the predictors described above, the analysis reported in this section tests whether the SEC's likelihood of prevailing is significantly associated with where the action is litigated. The analysis includes controls for case category, the identity of the defendant (individual or firm), and whether the action was based on a criminal prosecution or accompanied by a parallel criminal action.[252]

Table 6 below reports regression coefficients and measures of significance for four different data sets: the first, *Substantive Disposition*, includes all actions decided by a third-party adjudicator after trial, by summary disposition, or by motion to dismiss issued over the SEC's objection. The regression dubbed *Trial* includes only actions decided after a full trial and does not include dismissals or summary dispositions. The data analyzed in the *Trial* regression are the most similar to the data that the *Wall Street Journal* relied on to claim that a disparity in outcomes exists. The difference is that the *Wall Street Journal* collected information on outcomes in all cases decided between 2010 and 2015, regardless of when the cases were initially filed, whereas the results below include only cases filed between 2007 and 2015 and decided by September 15, 2016.

The final regressions labeled *Expanded* include all actions included in the *Substantive Disposition* model, as well as voluntary dismissals where the SEC moved to dismiss its case against the defendant because its case was weak (based on contemporaneous statements or news stories).[253] These regressions measure the SEC's likelihood of prevailing depending on the forum in which the action is filed. Importantly, because they include voluntary dismissals by SEC motion, the regression models labeled *Expanded* do not measure whether ALJs are more likely to rule for the SEC than courts.

As already noted, all regressions include cases that were filed in fiscal years 2007 to 2015 and were decided by September 15, 2016. For actions

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251. I searched for follow-on proceedings targeting defendants sued in court. The count likely understates the share of court defendants facing bars because the SEC can take some time to initiate follow-on proceedings after successful litigation in court.

252. In unreported regressions, I also controlled for the year in which the case was filed and the SEC Chair. Neither of the variables was statistically significant.

253. In addition, they include dismissals where no information on the reason for dismissal was available.

filed in FY 2013 and later, more than ten percent of the cases filed in court remain ongoing, which could bias the result.[254] To mitigate against the risk that defendants who litigate longer are more likely to prevail against the SEC, I also report regression coefficients based on the *Expanded* dataset including only cases filed in FY 2007 to 2012.[255]

Table 6:
Logistic Regression Coefficients[256]

	Substantive Disposition	**Trials**	**Expanded (incl. voluntary dismissal)**	
	2007–15	**2007–15**	**2007–15**	**2007–12**
ALJ[a]				
Log odds	0.22	0.44	0.79*	0.76
Wald (df=1)	0.33	0.99	5.01	2.52
Odds ratio	1.25	1.55	2.20	2.13
Firm				
Log odds	1.70**	1.74**	1.50**	1.55**
Wald (df=1)	13.89	7.67	17.51	14.64
Odds ratio	5.48	5.73	4.48	4.71
Based on Criminal				
Log odds	1.87**		2.34**	2.37**
Wald (df=1)	8.35		15.94	13.96
Odds ratio	6.48		10.43	10.69
Parallel Criminal [a]				
Log odds	-0.54		-0.62†	-0.71†
Wald (df=1)	1.57		2.81	2.71
Odds ratio	0.58		0.54	-0.49

254. Many of the cases that are ongoing are stayed pending the resolution of the parallel criminal case. As a result, it is not likely that the cases still pending are the ones the SEC is more likely to lose. If anything, the opposite is likely true.

255. I also ran regressions using only cases filed in FY 2007 to 2012 in the *Substantive Disposition* and *Trials* datasets, and the results were similar to those reported for the full dataset: predictor Court was not significant in any model whereas other predictors were either significant or not, and with the same signal.

256. The dependent variable is whether SEC won on at least one of the counts (SEC win is coded as 1). The variable ALJ codes actions decided by ALJ as 1 and by court as 0. The variable Firm codes actions against firms as 1 and against individuals as 0; the variable Based on Criminal codes actions based on criminal convictions as 1. In variable Category, actions targeting securities offering violations are coded as the baseline.

	Substantive Disposition	**Trials**	**Expanded (incl. voluntary dismissal)**	
	2007–15	**2007–15**	**2007–15**	**2007–12**
Category				
Wald (df=6)	68.06**	4.26	112.70**	98.29**
Securities Offering	20.74**	19.83†	1.52	2.44†
Wald	0.0	0.0	1.74	3.76
Odds ratio	n.a.	n.a.	4.59	11.42
Market Manipulation	2.93**	1.05†	1.70	2.52†
Wald	51.28	2.97	1.80	3.25
Odds ratio		2.85	5.50	12.43
Investment Adviser	2.90**	1.04	0.69	1.35
Wald	19.51	1.43	0.35	1.15
Odds ratio		2.83	1.99	3.85
Broker Dealer	2.22**	0.98	0.18	0.77
Wald	20.67	2.16	0.024	0.39
Odds ratio		2.66	1.12	2.15
Issuer Reporting	2.06**	0.99	-0.85	-0.51
Wald	14.95	2.35	0.56	0.18
Odds ratio		2.68	0.43	0.60
Insider Trading	0.83*	0.47	-1.87	-1.42
Wald	4.51	0.66	2.68	1.36
Odds ratio		1.61	0.15	0.24
Pseudo R^2	0.297	0.150	0.403	0.461
N	682	290	728	571

**p<0.01; *p<0.05; †p<0.1

[a] None of the dispositions at trial were based on a criminal conviction or plea, so the predictor is not included in the regression analysis.

Table 6 reports for each predictor three statistics generated by the logistic regression model. The first is a log odds coefficient, the second the Wald statistic, and the third an odds ratio. The log odds coefficient is a logarithmic measure of association between the response variable (i.e., SEC success) and the predictor. The Wald statistic is a measure of statistical significance: it tells one whether the observed association is so large that it is unlikely to appear by chance. The higher the Wald statistic, the more likely that the observed association between the two

variables is real.[257] The odds ratio is a more useful measure than the log odds coefficient: it quantifies the association. It is a relative measure of the effect, comparing the relative likelihood of success before an ALJ with the relative likelihood of success in court. For example, an odds ratio of 5.48 for the predictor Firm in the *Substantive Disposition* model implies that the SEC is 5.48-times as likely to prevail against a firm than against an individual defendant, all else being equal.

A positive log odds coefficient implies that the predictor and the response variable are positively correlated; a negative number suggests a negative correlation. All predictors used in the regression models are categorical. Three—ALJ, Firm, and Based on Criminal—are binary, where the observation takes on one of two values (i.e., ALJ or court, individual or firm, convicted or not). For each of the predictors, one of the options was chosen as the baseline. A logistic regression reports log odds coefficients as compared with a baseline, so the choice of baseline matters.[258] In the models reported above, the baseline value for the predictor Firm was litigation against a firm. Thus, the reported log odds coefficients measure the relationship between an SEC win in a case against a firm as compared with litigation against an individual. A positive coefficient suggests that the SEC is more likely to win against a firm than against an individual defendant, all else being equal. Similarly, the log odds coefficients in the regression model *Trial* for predictors ALJ and Based on Criminal are positive; given the selected baselines (litigation in court and no conviction, respectively), the SEC is more likely to prevail in a case filed before an ALJ and in an action against a defendant convicted for the same violation. The SEC is less likely to prevail when the action is accompanied by a parallel criminal case; this is what one might call the *Newman* effect. Many insider trading cases are accompanied by, but not based on, criminal indictments that are later dismissed.

The regression also includes the subject matter category as a fixed effect. Category is a qualitative predictor. The subject matters for enforcement actions are a finite set and there is no ordering between classes: an action for insider trading is not better or worse than an action for market manipulation. Cases categorized as "other" are used as the baseline to compare against other types of cases.

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257. *See* GARETH JAMES, DANIELA WITTEN, TREVOR HASTIE & ROBERT TIBSHIRANI, AN INTRODUCTION TO STATISTICAL LEARNING 134 (2015).

258. It does not matter for the calculation which is chosen as the baseline; the baseline only matters in interpretation and only because it determines whether the log odds coefficient is positive or negative. *See* HASTIE, THIBSHIRANI & FRIEDMAN, *supra* note 241, at 119.

As is common in studies reporting the results of a statistical analysis, coefficients that are statistically significant are marked with asterisks.[259] Notably, in the models most similar to the results reported in the *Wall Street Journal*, labeled *Trials* and *Substantive Disposition*, the variable ALJ is not statistically significant. In other words, even though the log odds coefficient for the predictor ALJ is positive in both models, the result does not allow one to reject the null hypothesis that there is no association between the type of forum in which an action is filed and case outcome. Contrary to the claims advanced by the *Wall Street Journal*,[260] the data analyzed do not support the conclusion that the SEC is more likely to win at trial decided by an ALJ than in one decided by a federal district judge once one controls for case category, the nature of the defendant, and the existence of parallel criminal proceedings.

What matters in adjudicated cases is not where the case is litigated but whether the targeted defendant is an individual and, to a lesser extent, what type of violation is charged.[261] The SEC is significantly less likely to prevail against individual defendants and against defendants targeted for insider trading and issuer reporting.[262]

The only model in which the type of forum is significantly associated with case outcomes is the third model labeled *Expanded*. Both the third and fourth columns include voluntary dismissals by the SEC. In the *Expanded* model that includes all contested cases filed between 2007 and 2015, the variable ALJ is statistically significant at $p<0.05$.[263] Holding other predictors constant, the SEC is statistically significantly more likely to win on at least one count when the case is filed in the administrative forum.

Even this result should be taken with reservations. Venue does not matter for cases decided by a judge or an ALJ; it is only significant when voluntary dismissals are included. This requires two additional caveats.

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259. One asterisk signals that the result is significant at $p<0.05$, which means that there is less than a 5% chance that there is no relationship between the response (SEC win) and the predictor (e.g., litigation in court). Two asterisks signal that the result is significant at $p<0.01$, which implies that there is less than a 1% chance that there is no relationship between the response and the predictor.

260. *See* Eaglesham, *supra* note 14; Eaglesham, *supra* note 114.

261. Using odds ratios reported in Table 6, the SEC is more than five times more likely to win when the defendant is a firm than when the defendant is an individual.

262. Using odds ratios reported in Table 6, compared with securities offering cases, the SEC is seventeen times less likely to prevail on a dispositive motion in insider trading cases and eight-times less likely to prevail in issuer reporting cases.

263. Note that if cases filed in FY 2012 are included as well, the variable Court is not statistically significant.

First, for many voluntary dismissals, conclusive contemporaneous evidence on why the case was dismissed is not available. When in doubt, the voluntary dismissal was coded as a defendant win.[264] To the extent some of these were not true wins, the result could be entirely due to coding error.[265] Second, the venue is not significant when cases filed after 2012 are excluded. Although the coefficients do not change much, the power of the test declines with a smaller sample.

This result remains unchanged in unreported models using fixed effects for the year in which the action was filed and for the SEC chair. In other words, individuals targeted in insider trading and issuer reporting actions are consistently more likely than other defendants to prevail against the SEC. Defendants convicted of crimes are significantly less likely to prevail against the SEC. The SEC has consistently filed cases for insider trading and issuers reporting in court. Contrary to the oft-repeated claims of statistical disparity, these results do not support the conclusion that defendants are more likely to win at trial in court than before ALJs, nor do they suggest that judges are more likely to rule for defendants than are ALJs. The analysis does suggest a possibility that defendants might fare better when the SEC targets them in court than before ALJs, but only if the SEC dismisses the case voluntarily, not if the case goes to a decision by a judge or an ALJ.

III. INTERPRETING THE RESULTS

The statistical analysis reported in Part II suggests that the *Wall Street Journal*'s data on which many advocates of reform have relied cannot be used to support the claim that the SEC is more likely to prevail when it litigates before ALJs. At the same time, the findings reported in this Article do not suggest that the type of forum is irrelevant. The SEC's expanded jurisdiction is new and too many of the post-Dodd-Frank cases are still ongoing, so none of the regressions validly test only post-Dodd-Frank data.

The gold standard in empirical studies is a double-blind randomized controlled experiment. Such experiments divide the sample into two groups that are similar along relevant dimensions, randomly assign one group to treatment (in this case, adjudication by ALJ), and observe whether treatment is correlated with different outcomes as compared

264. This includes about half of voluntary dismissals coded as defendant wins.

265. I ran a robustness check where the twenty voluntary dismissals without available evidence as to why they were dismissed were excluded from the model. The result was not statistically significant (log odds = 0.52; Wald = 2.06; odds ratio = 1.69).

with the control group.[266] Unfortunately, a double-blind study of outcomes in securities enforcement actions based on the type of forum is impossible because the SEC, as well as the ALJ or the judge deciding the case, know that the SEC chose to file the case in their forum.

And so, evidence of disparities must come from an observational study like the one printed in the *Wall Street Journal* and the one reported in this Article. Carefully designed observational studies can be used to identify significant associations between variables of interest, but trained statisticians caution users from drawing causal inferences based on observational studies.

This Article has catalogued the many problems with the *Wall Street Journal*'s report. But the empirical analysis in Part II, too, has significant limitations. This Part discusses two limitations: omitted variable bias and selection bias. It concludes with recommendations for further research.

A. The Missing Pieces: Omitted Variables and Selection Bias

The conclusion offered in section II.C.3 that the type of forum does not matter assumes that the included predictors capture the relevant characteristics of cases filed in either forum. If so, there is no robust statistically significant association between the forum in which an SEC enforcement action is litigated and the defendant's success against the SEC.

This assumption is certainly not satisfied. The regression models reported above omit important variables. Representation might matter: pro se defendants may be more likely to lose than those represented by counsel, in particular if counsel is experienced.[267] The ALJ or federal judge deciding the case might matter, or the SEC regional office that conducted the investigation. One could collect more data, but none of this is likely to be worth the effort because the two most important characteristics that are omitted, case quality and the SEC's perception of case quality, are either not easily measured or are not observable.

The type of forum where the case is litigated is not random. The SEC selects which cases to litigate in court and which ones to file in the administrative forum, so selection bias is a significant concern. It is possible that the SEC files in the administrative forum cases that it

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266. *See* John Concato, Nirav Shah & Ralph I. Horwitz, *Randomized, Controlled Trials, Observational Studies, and the Hierarchy of Research Designs*, 342 NEW ENG. J. MED. 1887 (2000) (demonstrating the superiority of randomized double blind control trials over observational studies).

267. *See* Zaring, *supra* note 20, at 1179 tbl.1.

believes it could not win in court—the charge lobbed by the *Wall Street Journal*.[268] If so, one would expect the SEC to win less often before ALJs than in court, assuming all else is equal.[269] Then, the finding of no disparity in success rates between the two different forums would be significant and important. It would suggest that the proverbial deck is stacked in favor of the SEC in administrative proceedings.[270]

Unfortunately, the complaints and the OIPs do not supply enough information to code consistently for case quality, and the cases where consistent coding could be possible, such as insider trading, are virtually all filed in court. External proxies, such as stock price movement on announcement of detected violation,[271] could be useful as a measure of the seriousness of the violation. But, stock-price data is limited to public firms, which represent only four percent of SEC enforcement actions and an even smaller slice of contested actions,[272] so it is not useful as a general measure of case quality. Moreover, if the concern is the SEC's opportunistic forum selection, then we would need a variable to measure the enforcement staff's perception of case quality. Unfortunately, that, too, is not observable at present.

There is a second selection bias effect that renders win ratios of limited value in assessing the fairness of SEC enforcement. Despite the interest in litigated cases, it is far more common for defendants to settle with the SEC. Over the period studied, about 40% of cases were filed as settled actions, and another 35% were settled during the proceedings.[273] But the ratio of settled cases from initiation is not stable. During the study period, the rate varied from a low of 32% in FY 2009 to a high of 48% in FY 2014. If the odds that a case will settle before the SEC files an enforcement action have changed, the proportion and thus the mix of cases that are contested has changed, too. In addition, the relative shares

268. *See* Eaglesham, *supra* note 14.

269. That is, assuming that success rates for like cases are the same in court and before ALJs.

270. Alternately, it is also possible that the SEC files easier cases or cases that it is *ex ante* more likely to win in the administrative forum. In that case, the finding of no disparity would suggest that ALJs are biased *against* the SEC.

271. *See* Jonathan M. Karpoff et al., *Proxies and Databases in Financial Misconduct Research* (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2112569 [https://perma.cc/ZPG6-8KEA] (discussing the use of stock market information in studies of financial misreporting).

272. *See* STEPHEN CHOI, SARA E. GILLEY, AND DAVID F. MARCUS, NYU POLLACK CTR. FOR LAW & BUS. AND CORNERSTONE RESEARCH, SEC ENFORCEMENT ACTIVITY AGAINST PUBLIC COMPANY DEFENDANTS, FISCAL YEARS 2010–2015, at 2 (2016), http://www.law.nyu.edu/sites/default/files/SEC-Enforcement-Activity-FY2010-FY2015.pdf [https://perma.cc/4EJE-MVNB].

273. The ratio for settled cases is based on cases that have been resolved and does not include ongoing cases. *See* discussion *supra* section II.C.1.

of settled actions filed in different venues have not remained stable. Fewer of the cases filed in court are filed as settled cases: 30% in FY 2007 and 15% in FY 2015. On the other hand, the relative share of cases filed as settled in the administrative forum has remained stable at 80%.[274]

Defendants' willingness to settle may be affected by their perception that ALJs are less fair.[275] The SEC has reportedly threatened investigated parties with litigation before ALJs if they are unwilling to settle.[276] As a result, more parties might be settling post-Dodd-Frank than before and thus the types of cases that are adjudicated and the forum in which they are adjudicated have changed. At the same time, at least some defendants' willingness to settle may have declined after the *Wall Street Journal*'s reporting.[277] As some defendants have succeeded in lawsuits seeking to enjoin administrative proceedings, others may have been encouraged to contest charges instead of settling. If the types of cases that are contested keep changing, any long-term analysis of case outcomes is problematic unless we could capture relevant characteristics to control for such changes.

The SEC's enforcement practices, too, have changed over time. Between 2007 and 2015, the SEC lived through three Chairs with vastly different priorities and underwent a serious restructuring of its Enforcement Division.[278] The restructuring reportedly improved the morale of employees; it also changed the level of enforcement activity.[279] Finally, the SEC has changed where it files contested cases.[280] While absolute numbers are a single figure, success rate is a ratio comprised of two numbers: the numerator and the denominator.

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274. There was a decline in 2012 and 2013 to 61% and 65%, respectively. Data on file with author.

275. *See* Brian Mahoney, *SEC Could Bring More Insider Trading Cases In-House*, LAW360 (June 11, 2014, 6:53 PM), http://www.law360.com/articles/547183/sec-couldbring-more-insider-trading-cases-in-house [https://perma.cc/V7V8-8TVQ].

276. *See id.* (quoting SEC Enforcement Director Ceresney as saying the SEC "threatened administrative proceedings" and the defendant settled).

277. This can be true even if the overall settlement rate increased. Since 2013, the SEC has brought a considerable number of sweeps targeting large groups of defendants for similar violations. Such defendants invariably settle, which increases both the numerator and the denominator to calculate the ratio of cases that are filed as settled actions. A settlement ratio that includes sweeps can mask the fact that defendants other than those targeted in sweeps are less likely to settle.

278. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-358, SECURITIES AND EXCHANGE COMMISSION: GREATER ATTENTION NEEDED TO ENHANCE COMMUNICATION AND UTILIZATION OF RESOURCES IN THE DIVISION OF ENFORCEMENT (2009).

279. *See id.*

280. *See* Eaglesham, *supra* note 122.

One can change the success rate by changing either the number of cases brought, the number of successes, or both. As such, success rates are more vulnerable to small changes in inputs and the biases discussed above.

All of these factors suggest that success rates are not a useful measure of fairness in SEC enforcement. It is unfortunate that they have become one, and even more unfortunate that the *Wall Street Journal* report that stirred the controversy was done so poorly and over-claimed so extensively.

B. Beyond the Empirics

The *Wall Street Journal*'s report can serve as a useful cautionary tale. It combined bold claims and seemingly straightforward data analysis to make the case that the SEC was treating defendants unfairly. It confirmed the perceptions that the SEC was a sore loser and was changing the rules of the game to ensure it would win in the future.

The perception that ALJs supply a lesser form of fairness is likely to persist.[281] After the analysis offered in this Article, one would hope that better-researched and supported empirical analyses will replace news stories in the ongoing debate about the fairness of the administrative forum. Because empirical evidence is lacking, the debate about the fairness of administrative adjudication and the appropriate remedies should be held on the policy merits and demerits. There are good and bad arguments advanced by both the SEC and its critics. What the battling sides hopefully will accept is that the data in this debate is no trump card.

The ultimate result might be that the SEC amends procedural rules before ALJs again to model them more closely on the Federal Rules of Civil Procedure, as some commentators have proposed.[282] It might be to enable courts to decide what forum is most appropriate to resolve an SEC enforcement action.[283] But that is unlikely to satisfy everyone. Both

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281. *See, e.g.*, McLucas & Martens, *supra* note 6, at A17 ("Democratic self-governance requires that the governed be generally convinced of the system's evenhandedness. We are concerned that the SEC is damaging the perceived legitimacy of how the agency uses its enforcement power."); 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 [https://perma.cc/RT5C-F6P7] ("To avoid the perception that the Commission is taking its tougher cases to its in-house judges, and to ensure that all are treated fairly and equally, the Commission should set out and implement guidelines for determining which cases are brought in administrative proceedings and which in federal courts.").

282. *See, e.g.*, Bondi, Ortiz & Wheatley, *supra* note 29; Zornow, *supra* note 132.

283. *See* Grundfest, *supra* note 30.

bills introduced in Congress include removal provisions that would entitle defendants to remove any action to federal district court and raise the burden of persuasion if the case were to stay in the administrative forum.[284] Practitioners have proposed that the Commission "bring all but its most routine cases in federal court."[285]

These proposals are associated with significant costs that could surpass any purported benefits.[286] Removing most cases to court would increase the workload for and stress the already overburdened federal judiciary[287] without meaningfully improving either defendants' procedural protections or their likelihood of success. Giving defendants the incentive to remove cases to court would drain the SEC's resources, thus reducing overall enforcement levels unless Congress were to appropriate additional funds. In addition, in-court adjudication could introduce errors as well. Complex regulatory matters may be beyond the capacity of even the most dedicated layperson jurors, and so removing securities enforcement actions to the courts could reduce the predictability of outcomes.[288] On the other hand, unsettled legal questions are perhaps better left to federal judges. The choice of forum involves trade-offs, and no single type of forum is best for all types of disputes brought by a regulator with broad enforcement authority such as the SEC.

CONCLUSION

It is hardly news that a news story got an important fact wrong. The *Wall Street Journal*'s story is unusual in the significant influence that it has had on the law and the practice of securities enforcement. Many of the power players in securities regulation have referenced the alleged disparity, including judges deciding securities cases, a sitting SEC Commissioner, and congressmen advancing statutory amendments. The reported disparity led the SEC itself to amend its Rules of Practice. Despite the effort, the SEC's administrative adjudication continues to

284. *See* discussion *supra* notes 126–30 and accompanying text.

285. Brune, *supra* note 29, at 5.

286. *See* Grundfest, *supra* note 30, at 1184.

287. *See* Peter J. Henning, *Reforming the SEC's Administrative Process*, N.Y. TIMES (Oct. 26, 2015), http://www.nytimes.com/2015/10/27/business/dealbook/reforming-the-secs-administrative-process.html [https://perma.cc/8S9Z-RR56] (speculating that more cases would be filed in court).

288. *See generally* Davison et al., *supra* note 22, at 104 (observing that complex issues can be "outside the experience and understanding of a typical layperson jury").

face scrutiny. This is a remarkable feat for any empirical study, let alone a seriously deficient one.

This Article offers a more careful and comprehensive alternative analysis of SEC success rates. It reports that there is no robust correlation between the selected forum and case outcome. This finding does not imply that the type of forum in which the SEC litigates does not matter. Rather, there are significant empirical obstacles to finding any useful results by comparing case outcomes.

The controversy about the fairness of SEC enforcement in the administrative forum will no doubt continue. By discrediting the data that many of the SEC's critics have used to buttress their claims, this Article hopes that the debate can proceed at a lower volume and offer more measured solutions than some of the proposals advanced thus far.

APPENDIX

Table 7:
Success by Case Category,
Including Voluntary Dismissals (Expanded)

	SEC win	Number and win rate by category				Total	Overall SEC win rate
		Court	SEC win %	AP	SEC win %		
Overall	Yes	451	80.5%	150	89.3%	601	82.6%
	No	109		18		127	
Insider Trading	Yes	38	40.9%	2	50.0%	40	41.2%
	No	55		2		57	
Issuer Reporting	Yes	35	56.5%	14	77.8%	49	61.1%
	No	27		4		31	
Broker-Dealer	Yes	23	85.2%	53	88.3%	76	87.4%
	No	4		7		11	
Investment Adviser	Yes	54	93.1%	47	90.4%	101	91.2%
	No	4		5		9	
Market Manipulation	Yes	54	94.7%	3	100%	57	95.0%
	No	3		0		3	
Securities Offering	Yes	246	94.3%	21	100%	267	94.7%
	No	15		0		15	

Table 8:
Success by Case Category after Trial or ALJ Initial Decision[289]

	SEC win	Number and win rate by category				Total	Overall SEC win rate
		Court	SEC win %	AP	SEC win %		
Overall	Yes	105	82.7%	146	89.6%	251	86.6%
	No	22		17		39	
Insider Trading	Yes	22	73.3%	2	66.7%	24	72.7%
	No	8		1		9	
Issuer Reporting	Yes	18	81.8%	14	77.8%	32	80.0%
	No	4		4		8	
Broker-Dealer	Yes	9	90.0%	53	88.3%	62	88.6%
	No	1		7		8	
Investment Adviser	Yes	11	91.7%	43	89.6%	54	90.0%
	No	1		5		6	
Market Manipulation	Yes	11	84.6%	3	100%	14	87.5%
	No	2		0		2	
Securities Offering	Yes	34	85.0%	19	100%	53	89.8%
	No	6		0		6	

289. The Table includes dispositions after jury or bench trial for cases filed in court and dispositions of ALJ initial decision after a hearing (not including cases decided by default) (i.e., the same as Reduced dataset in section II.C.3).