SEC ADMINISTRATIVE PROCEEDINGS AND EQUAL PROTECTION "CLASS OF ONE" CHALLENGES: EVALUATING CONCERNS ABOUT SEC FORUM CHOICES

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In the years since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission has made use of its new authority to initiate administrative proceedings against individuals who previously would have faced action in federal court. Several individuals have challenged the SEC's decision to bring enforcement actions in the administrative forum as a violation of equal protection rights. Their arguments draw on two Supreme Court cases—Village of Willowbrook v. Olech *and* Engquist v. Oregon Department of Agriculture—*that allow "classes of one" to pursue equal protection claims.*

This Note addresses this recent string of challenges. It aims to show that the current system is open to abuse and can potentially lead to the sort of unfair treatment that the Equal Protection Clause of the Constitution condemns. As such, the system by which the SEC selects a forum is in need of reforms that will alleviate the present concerns. The SEC should implement changes to minimize the burdens individuals face in administrative proceedings and should also provide greater transparency about its rationale for selecting a particular forum.

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I. INTRODUCTION

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") expanded the enforcement powers of the United States Securities and

Exchange Commission ("SEC").[1] Section 929P of Dodd-Frank amends various statutes to grant the SEC authority to pursue administrative actions for civil penalties against unregistered entities.[2]

In the years since the passage of Dodd-Frank, the SEC has started to make use of its new authority and has initiated administrative proceedings against individuals who previously would have faced action in federal court.[3] Notably, the SEC continues to pursue most of its enforcement actions in federal court.[4] Several individuals whom the SEC pursued in its administrative forum have challenged that forum choice as a violation of equal protection rights.[5] Those individuals emphasize in their lawsuits that defendants face many challenges in administrative proceedings and argue that it is impermissible to single them out while other similar defendants remain in federal court.[6] Their arguments draw on Supreme Court decisions that allow "classes of one" to pursue equal protection claims.[7]

This Note addresses the recent string of equal protection challenges to SEC administrative proceedings. It aims to show that the current system is open to abuse and can potentially lead to the sort of unfair treatment that the

1 *See* Bennett Rawicki, *The Dodd-Frank Act and SEC Enforcement—The Significant Expansions and Remaining Limitations on the SEC's Enforcement Scope and Arsenal*, 41 SEC. REG. L.J. 35, 35 (2013).

2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376 (2010).

3 *See* Chad Bray & Jean Eaglesham, *SEC, Rajat Gupta Drop Their Cases, For Now*, WALL ST. J., Aug. 5, 2011, at C3 ("The action against Mr. Gupta was the first since the SEC received expanded powers . . . . In the past, the SEC could seek civil penalties only from people associated with registered firms.").

4 *See* Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL ST. J., Oct. 21, 2014, at A4 (discussing number of administrative proceedings and federal cases). *But see* Jenna Greene, *The SEC's on a Long Winning Streak*, NAT'L L.J., Jan. 19, 2015 (noting that in 2013 the percentage of cases brought administratively increased to forty-three percent).

5 *See* discussion *infra* Part II.B.

6 *Id.*

7 *See infra* Part II.C.

Equal Protection Clause of the Constitution condemns. As such, the SEC should reform its forum selection procedures to alleviate present concerns about violations of defendants' equal protection rights.

Part II of this Note explores the recent cases that challenge SEC administrative proceedings on equal protection grounds and the Supreme Court cases that set forth the "class of one" doctrine upon which those challenges rely. Part III analyzes the validity of the equal protection argument and concludes that there is cause for concern with current SEC practices. Part IV discusses potential reforms to the process of selecting a forum that will minimize concerns about equal protection violations.

II. BACKGROUND AND RECENT DEVELOPMENTS

A. Changes to SEC Enforcement Powers Under Dodd-Frank

In 2010, Dodd-Frank expanded the enforcement powers of the Securities and Exchange Commission.[8] Section 929P of Dodd-Frank amended Section 8A of the Securities Act of 1933, Section 9(d)(10) of the Investment Company Act of 1940, Section 203(i)(l) of the Investment Advisers Act of 1940, and Section 21B(a) of the Securities Exchange Act of 1934.[9] Prior to Dodd-Frank, administrative proceedings could be used only against registered entities such as brokerage firms and investment advisors, but these amendments allowed the SEC to seek civil penalties against unregistered entities, including individuals, through such proceedings.[10]

SEC administrative proceedings differ markedly from federal court proceedings. An administrative proceeding is

8 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376 (2010).

9 *Id.*

10 *See* Gibson, Dunn & Crutcher LLP, *The Dodd Frank Act Reinforces and Expands SEC Enforcement Powers* (July 21, 2010), http://www.gibsondunn.com/publications/pages/Dodd-FrankActReinforcesAndExpandsSECEnforcementPowers.aspx [http://perma.cc/KNY4-XLTH].

an internal SEC hearing that is governed by the agency's Rules of Practice.[11] In these proceedings, an Administrative Law Judge ("ALJ") serves as the finder of fact and law.[12] The proceedings allow only limited discovery, are conducted on an expedited timeline, have a lower burden of proof, and are subject to different evidentiary rules.[13] Neither the Federal Rules of Civil Procedure nor the Federal Rules of Evidence apply to these actions.[14] Additionally, the SEC itself reviews the decisions of the ALJs.[15] Only after a final order by the Commission may defendants bring an appeal to a United States Court of Appeals.[16] In October 2015, after years of criticism, the SEC finally proposed amendments to its Rules of Practice that would make its administrative proceedings more like litigation in federal court.[17] These proposed changes are discussed in more detail in Part IV of this Note, but, as other commenters have observed, they are but a "small step" in the right direction.[18]

Recent statements by SEC officials indicate that the agency intends to use its power to initiate administrative proceedings against non-registered entities more

11 *See* 17 C.F.R. § 201.100(a) (2014).

12 *See* Peter K.M. Chan et al., *There's No Place Like Home: SEC Increasingly Uses Administrative Proceedings*, MORGAN LEWIS & BOCKIUS LLP (Dec. 22, 2014), http://www.morganlewis.com/pubs/theres-no-place-like-home-sec-increasingly-uses-administrative-proceedings [http://perma.cc/3L8U-SCV8].

13 *See* John C. Coffee, Jr., *The 'Inside Baseball' of Insider Trading*, N.Y.L.J., Mar. 17, 2011 (discussing some of the differences between actions in federal court and in the administrative forum).

14 *See* Rawicki, *supra* note 1, at 44–46.

15 *See* Russell G. Ryan, *The SEC as Prosecutor and Judge*, WALL ST. J., Aug. 5, 2014, at A13 (discussing this and other disadvantages defendants face in administrative proceedings).

16 *See* Rawicki, *supra* note 1, at 69 n.126.

17 Amendments to the Commission's Rules of Practice, 80 Fed. Reg. 60,091 (proposed Oct. 5, 2015) (to be codified at 17 C.F.R. pt. 201) [hereinafter Proposed Amendments].

18 Peter J. Henning, *A Small Step in Changing S.E.C. Administrative Proceedings*, N.Y. TIMES (Sept. 28, 2015), http://www.nytimes.com/2015/09/29/business/dealbook/a-small-step-in-changing-sec-administrative-proceedings.html [http://perma.cc/5CUU-6AM8].

frequently.[19] Its decision to nearly double the number of judges and attorneys employed at its Office of Administrative Law Judges further demonstrates that intent.[20] The SEC initiated at least thirty-five percent more administrative proceedings in 2014 than it did in 2012.[21] Indeed, the number of administrative proceedings brought last year was double the amount brought in 2009, before the passage of Dodd-Frank.[22]

B. Recent Equal Protection Challenges to SEC Administrative Proceedings

Given the numerous differences identified above between federal courts and the SEC administrative forum, a number of individuals have objected to administrative proceedings on due process grounds. Specifically, as discussed below, defendants singled out for administrative action object when similarly situated defendants are pursued in federal court. These individuals have argued that such practices amount to equal protection violations because the administrative proceedings subject them to disparate treatment absent a legitimate purpose.[23] Though the facts and circumstances of each case differ slightly, the common elements of each defendant's argument are that (i) the administrative forum imposes burdens not present in federal court, (ii) the defendant is being treated differently than others in the

19 *See* Brian Mahoney, *SEC Could Bring More Insider Trading Cases In-House*, LAW360 (Jun. 11, 2014), http://www.law360.com/articles/547183/sec-could-bring-more-insider-trading-cases-in-house [http://perma.cc/S9FY-CD97] (noting statements by Andrew Ceresney, head of the SEC's Division of Enforcement, that he believes the agency will make use of the forum more often going forward).

20 *See* Joel M. Cohen, Mary Kay Dunning & Darcy Harris, *SEC Plans to Play Insider-Trading Cases on Home Court*, NAT'L L.J. (Sept. 16, 2014), http://www.gibsondunn.com/publications/Documents/CohenDunningHarris-SECPlansToPlayInsiderTradingCases.pdf [http://perma.cc/LQF6-J9GY].

21 Chan et al., *supra* note 12, at 2.

22 *See* Greene, *supra* note 4.

23 *See* discussion *infra* Parts II.B.1–4.

same situation, and (iii) no justification exists for such disparate treatment.[24]

1. *Gupta v. SEC*

The first case to challenge an SEC administrative proceeding on equal protection grounds was *Gupta v. SEC*.[25] Rajat Gupta was a former employee of McKinsey & Company who served as an outside director on the board of several companies, including Proctor & Gamble and Goldman Sachs.[26] Under the new authority granted by Dodd-Frank, the SEC initiated administrative proceedings against Gupta alleging that he engaged in an insider-trading scheme involving Galleon Management and its founder, Raj Rajaratnam.[27] Prior to initiating the proceeding against Gupta, the SEC commenced twenty-seven civil actions in the United States District Court for the Southern District of New York seeking penalties for insider trading against other individuals related to Galleon and Rajaratnam.[28] In response to the SEC's decision to proceed against him in the administrative forum, Gupta filed suit in the Southern District seeking declaratory and injunctive relief. He alleged that the SEC had "unfairly and unconstitutionally singl[ed] [him] out."[29] The SEC then filed a motion to dismiss the case on several grounds.[30]

Ruling on the motion to dismiss, Judge Rakoff appeared sympathetic to Gupta's equal protection argument. He began his opinion by observing that "[a] funny thing happened on the way to this forum. On March 1, 2011, the Securities and Exchange Commission . . . decided it preferred its home

24 *See* discussion *infra* Parts II.B.1–4.

25 Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

26 Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 3–4, *Gupta*, 796 F. Supp. 2d 503 (No. 11-cv-1900) [hereinafter Gupta Complaint].

27 *Id.* at 3.

28 *Id.* at 6.

29 *Id.* at 2.

30 Memorandum of Law in Support of Motion to Dismiss Complaint, *Gupta*, 796 F. Supp. 2d 503 (No. 11-cv-1900).

turf."[31] Judge Rakoff ultimately denied the SEC's motion to dismiss while limiting the complaint to the equal protection claim, which he ruled should proceed on an expedited basis.[32] He noted that the complaint "alleges that the SEC intentionally, irrationally, and illegally singled Gupta out for unequal treatment" and that "[t]hese allegations . . . would state a claim even if Gupta were entirely guilty of the charges made against him."[33] Furthermore, "even if the SEC were acting within its discretion when it imposed disparate treatment on Gupta, that would not necessarily exculpate it from a claim of unequal protection if the unequal treatment was still arbitrary and irrational."[34]

Given the posture of the case, the merits of Gupta's equal protection claim were not at issue. The court ruled merely that Gupta had stated a claim sufficient to survive a motion to dismiss. It explained that "the selective prosecution/equal protection claim will turn entirely on extrinsic evidence of whether the SEC's decision to treat Gupta differently from the other Galleon-related defendants was irrational, arbitrary, and discriminatory."[35] As Judge Rakoff acknowledged, "it would not be prudent to allow every subject of an SEC enforcement action who alleges 'bad faith' and 'selective prosecution' to be able to create a diversion by bringing a parallel action in federal district court."[36] However, he further opined that before him was "the unusual case where there is already a well-developed public record of Gupta being treated substantially differently from 27 essentially identical defendants, with not even a hint from the SEC, even in their instant papers, as to why that should be so."[37]

31 *Gupta*, 796 F. Supp. 2d at 506.

32 *Id.* at 513 (citing United States v. Armstrong, 517 U.S. 456 (1996)).

33 *Gupta*, 796 F. Supp. 2d at 513.

34 *Id.* (citing Village of Willowbrook v. Olech, 528 U.S. 562, 564–66 (2000)). *See infra* Part II.C for discussion of the "class of one" doctrine that supports this argument by Judge Rakoff.

35 *Gupta*, 796 F. Supp. 2d at 514.

36 *Id.*

37 *Id.*

Unfortunately for other defendants who would later be subjected to similar treatment by the SEC, the court never reached the merits of Gupta's equal protection argument. Perhaps because the SEC sensed Judge Rakoff's doubts about its conduct,[38] it reached an agreement with Gupta to cut off the administrative proceeding and instead brought an action in district court.[39] Indeed, four years later, no court has yet ruled on the merits of these claims despite an increasing number of cases that raise the same argument.[40]

2. *Jarkesy v. SEC*

Jarkesy v. SEC was the next case in the line of equal protection cases challenging SEC administrative proceedings against individuals.[41] Jarkesy's complaint alleged that by commencing an administrative proceeding rather than an action in federal court, "the SEC had treated Plaintiffs differently—to their detriment—from others similarly situated."[42] Furthermore, he noted that the administrative proceeding presented "an extremely high volume of evidence, virtually no discovery, no protection of the Federal Rules of Civil Procedure, no counterclaims, no Federal Rules of Evidence (or any discernable standard governing evidence), no jury, and no Article III judge . . . ."[43] He identified nine other cases in a similar time frame to his own wherein the

38 Significantly, Judge Rakoff continues to criticize the SEC's use of administrative proceedings. *See* discussion *infra* Part III.B.

39 *See* Joint Stipulated Order of Dismissal at 1–2, *Gupta*, 796 F. Supp. 2d 503 (No. 11-cv-1900).

40 Judge Rakoff and Judge Kaplan of the Southern District of New York have both expressed some views regarding the equal protection claims in their opinions, but neither has directly ruled on the matter. *See Gupta*, 796 F. Supp. 2d at 503; Chau v. SEC, 72 F. Supp. 3d 417, 430–46 (S.D.N.Y. 2014). Furthermore, an appellate brief in another case describes the issues as matters of "first impression." Brief for Appellants at 4, Jarkesy v. SEC, 803 F.3d 9 (D.C. Cir. 2015) (No. 14-5196).

41 Jarkesy v. SEC, 48 F. Supp. 3d 32 (D.D.C. 2014).

42 Complaint at 9, *Jarkesy*, 48 F. Supp. 3d at 32 (No. 14-cv-114) [hereinafter Jarkesy Complaint].

43 *Id.*

SEC pursued similar charges and remedies but elected to proceed in federal court.[44]

The court in *Jarkesy*, however, concluded that it lacked jurisdiction and that Jarkesy would need to raise his equal protection claim in the administrative proceeding itself or on appeal of that proceeding.[45] Jarkesy appealed that decision in August 2014 and oral argument took place before the United States Court of Appeals for the District of Columbia Circuit in April 2015.[46] On September 29, 2015, the Court of Appeals affirmed the district court's dismissal for lack of subject matter jurisdiction.[47] It concluded that Congress had "implicitly precluded concurrent district-court jurisdiction over challenges like Jarkesy's" and noted that Jarkesy "can secure judicial review in a court of appeals when (and if) the [administrative] proceeding culminates in a resolution against him."[48]

3. *Chau v. SEC*

Chau v. SEC is yet another similar case.[49] The SEC initiated administrative proceedings alleging that Chau and others committed fraud relating to the creation and marketing of collateralized debt obligations ("CDOs"). As collateral manager, Chau typically would be responsible for selection, acquisition, and monitoring of CDO portfolios, but he allegedly failed to disclose to investors that a hedge fund had substantial influence over his selection process.[50] After the SEC initiated its proceeding, Chau filed suit in the Southern District of New York, arguing that he was

44 *Id.*

45 *Jarkesy*, 48 F. Supp. 3d at 37–40.

46 *See* Notice of Appeal, *Jarkesy*, 48 F. Supp. 3d at 32 (No. 14-cv-114); Courtroom Minutes of Oral Argument, Jarkesy v. SEC, 803 F.3d 9 (D.C. Cir. 2015) (No. 14-5196).

47 *Jarkesy*, 803 F.3d at 9, 30.

48 *Id.* at 12.

49 *See* Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial, Chau v. SEC, 72 F. Supp. 3d 417 (S.D.N.Y. 2014) (No. 14-cv-1903) [hereinafter Chau Complaint].

50 *Id.* at 6.

"suffering, and will continue to suffer, as a result of the Commission's decision to single [him] out and deprive [him] of the ordinary protections [he] would enjoy in an enforcement proceeding before [the district court]."[51] Chau observed that, despite the existence of at least four similar contested CDO cases, his was the first and only case of its type brought as an administrative proceeding.[52] In December 2014, Chau lost his bid to halt the administrative proceedings.[53] The court ruled that it did not have subject matter jurisdiction and dismissed the case.[54] Chau appealed in February 2015 and the case is now pending before the United States Court of Appeals for the Second Circuit.[55]

4. *Peixoto v. SEC*

Another recent case, *Peixoto v. SEC*, filed on October 22, 2014, rehashes the claims and arguments previously discussed. Peixoto noted that the SEC had brought 156 insider trading cases in federal court since Dodd-Frank, but had pursued only three such cases through administrative proceedings.[56] Relying on this evidence, he argued that he was being singled out for disparate treatment and that there was no rational relationship between that treatment and any legitimate government interest.[57] During the case, however, the SEC Division of Enforcement filed a motion with the Commission requesting that it dismiss the charges against Peixoto in the administrative proceeding.[58] Given that dismissal of the charges would render Peixoto's suit moot, Judge Pauley of the United States District Court for the

51 *Id.* at 12.

52 *Id.* at 8–11.

53 *Chau*, 72 F. Supp. 3d at 437.

54 *Id.*

55 *See* Notice of Appeal, *Chau*, 72 F. Supp. 3d at 417 (No. 14-cv-1903).

56 Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 4, Peixoto v. SEC, No. 14-cv-8364 (S.D.N.Y. filed Oct. 20, 2014) [hereinafter Peixoto Complaint].

57 *Id.* at 20–24.

58 *See* Order Granting Letter Motion to Adjourn Conference and Stay Action at 1, Peixoto v. SEC, No. 14-cv-8364 (S.D.N.Y. filed Dec. 16, 2014).

Southern District of New York stayed the action until that motion was resolved.[59] The SEC subsequently dismissed the administrative proceeding[60] and the parties then submitted a notice of voluntary dismissal in the district court.[61]

5. Summary of Cases and Looking Forward

Despite the concerns described above, the SEC has indicated that it intends to increase its use of administrative proceedings.[62] To the extent the SEC continues using the administrative forum selectively, and to the extent its decision-making process remains opaque, equal protection concerns will linger. It is likely that eventually one of the cases now pending—or one to be filed in the near future—will have its equal protection argument assessed on the merits. Even after this initial assessment, challenges are likely to continue until a definitive precedent resolves the matter. When the courts do eventually get to the merits of these cases, the line of Supreme Court opinions dealing with equal protection claims for "classes of one" will play an influential role.

C. "Class of One" Equal Protection Cases

1. *Village of Willowbrook v. Olech*

The cases discussed above challenging SEC administrative proceedings on equal protection grounds rely on a doctrine, known as "class of one," first articulated by the Supreme Court in *Village of Willowbrook v. Olech*.[63] In a

59 *Id.*

60 Peixoto, Exchange Act Release No. 74176, 2015 WL 366001 (Jan. 29, 2015) (order dismissing proceeding).

61 Notice of Voluntary Dismissal Pursuant to Fed. R. Civ. P. 41(a)(1)(A)(i), Peixoto v. SEC, No. 14-cv-8364 (S.D.N.Y. filed Jan. 30, 2015).

62 *See* Mahoney, *supra* note 19 (describing statements by Andrew Ceresney, head of the SEC's Division of Enforcement, that the agency will make use of the administrative forum more often going forward).

63 Village of Willowbrook v. Olech, 528 U.S. 562 (2000) (per curiam). Note, however, as one scholar explained, "[w]hile Olech is often described

brief *per curiam* opinion, the Court explained that its "cases have recognized successful equal protection claims brought by a 'class of one,' where the plaintiff alleges that she has been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment."[64] Olech and her husband had requested that the village connect their home to the local water supply. The village agreed, but on the condition that the Olechs grant a thirty-three foot easement. Previously the town had required only fifteen-foot easements in response to similar requests from other property owners.[65] The Olechs sued, claiming that the village's demand was arbitrary and unreasonable and was the result of ill will arising out of an earlier dispute with the town. The Supreme Court concluded that Olech had stated a valid equal protection claim under the "class of one" theory.[66]

The Supreme Court's adoption of the class of one doctrine had potentially vast implications, but the brief opinion offered relatively little guidance to lower courts. Indeed, on its face, *Olech* "officially opened the door for any person suffering adverse government treatment to point to others, allegedly similarly-situated, who did not suffer the same treatment and claim a violation of equal protection."[67] Lower courts struggled to deal with the implications of the idea that the Equal Protection Clause did not protect solely against class-based discrimination[68] and began crafting a range of different approaches to limit the potentially wide reach of

as inaugurating the class-of-one theory of equal protection, in fact, Olech simply confirmed a theory that a number of lower courts had long accepted." William D. Araiza, *Constitutional Rules and Institutional Roles: The Fate of the Equal Protection Class of One and What it Means for Congressional Power to Enforce Constitutional Rights*, 62 SMU L. REV. 27, 38 (2009).

64 *Olech*, 528 U.S. at 564 (citing Sioux City Bridge Co. v. Dakota Cty., 260 U.S. 441 (1923); Allegheny Pittsburgh Coal Co. v. Cty. Comm'n, 488 U.S. 336 (1989)).

65 *Id.* at 563.

66 *Id.* at 564–65.

67 Araiza, *supra* note 63, at 49.

68 *Id.*

the doctrine.[69] Some courts imposed heightened pleading standards that required plaintiffs to establish that truly similar individuals in fact existed.[70] Other courts continued to require a showing of animus despite the Supreme Court's indication in *Olech* that this was not a necessary element.[71] Generally, these various efforts sought to balance important government interests against the potentially wide scope of the constitutional principle set forth by the Supreme Court.[72]

2. *Engquist v. Oregon Department of Agriculture*

In 2008, the Supreme Court again addressed the class of one doctrine in *Engquist v. Oregon Department of Agriculture*.[73] Though the case dealt narrowly with equal protection in the public employment context—and shut the door to class of one claims in that area—its analysis provides broader insight into the Court's views on the class of one doctrine.[74]

Engquist was a public employee of Oregon and filed a class of one suit alleging that her superiors fired her for "arbitrary, vindictive, and malicious reasons."[75] In applying its previous decision to these facts, the Court in *Engquist* emphasized that *Olech* had not been a departure from traditional equal protection principles, but rather an application of those existing principles.[76] It explained,

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69 *Id.* at 49–54 (describing decisions that required the showing of animus, that imposed heightened proof requirements, and that demanded a high degree of similarity, among other efforts).

70 *Id.* at 50 (citing Jennings v. City of Stillwater, 383 F.3d 1199, 1213–14 (10th Cir. 2004); Hayden v. Ala. Dep't of Pub. Safety, 506 F. Supp. 2d 944, 957 (M.D. Ala. 2007)).

71 *See, e.g.*, Harlen Assocs. v. Inc. Vill. of Mineola, 273 F.3d 494, 500 (2d Cir. 2001) (noting a split among district and circuit courts over whether an animus requirement remained).

72 Araiza, *supra* note 63, at 49–50.

73 Engquist v. Or. Dep't of Agric., 553 U.S. 591 (2008).

74 *See* Araiza, *supra* note 63, at 54–55.

75 *Engquist*, 553 U.S. at 595.

76 *Id.* at 602 ("Recognition of the class-of-one theory of equal protection on the facts in *Olech* was not so much a departure from the

"[w]hen those who appear similarly situated are nevertheless treated differently, the Equal Protection Clause requires at least a rational reason for the difference, to ensure that all persons subject to legislation or regulation are indeed being 'treated alike, under like circumstances and conditions.'"[77]

The *Engquist* Court nonetheless declined to allow class of one suits in the public employment context. Specifically, the Court distinguished the decision-making involved in the employment context from that involved in *Olech*, writing:

> What seems to have been significant in *Olech* and the cases on which it relied was the existence of a clear standard against which departures, even for a single plaintiff, could be readily assessed. There was no indication in *Olech* that the zoning board was exercising discretionary authority based on subjective, individualized determinations . . . . Rather, the complaint alleged that the board consistently required only a 15-foot easement, but subjected Olech to a 33-foot easement. This differential treatment raised a concern of arbitrary classification.[78]

In contrast, the Court explained, certain forms of state action "by their nature involve discretionary decision making based on a vast array of subjective, individualized assessments."[79] The Court concluded that the decision to terminate public employment fell within that category.[80] Thus, a class of one equal protection claim could not be founded on such an action.

3. *United Statse v. Moore*

In *United States v. Moore*, the defendant raised a class of one equal protection challenge and argued that he had been

principle that the Equal Protection Clause is concerned with arbitrary government classification, as it was an application of that principle.").

77 *Id.*

78 *Id.* at 602–03.

79 *Id.* at 603.

80 *Id.* at 605.

irrationally subjected to a mandatory minimum sentence that did not apply to other defendants charged in state, rather than federal, court.[81] The United States Court of Appeals for the Seventh Circuit quoted from *Enquist* to conclude that "the class-of-one theory is better suited to those contexts involving 'a clear standard against which departures, even for a single [individual], could be readily assessed.'"[82] The court ruled that the exercise of prosecutorial discretion was sufficiently similar to the circumstances in *Engquist* to justify a similar bar on class of one challenges.[83] Ultimately, the court concluded that class of one challenges are "just as much a 'poor fit' in the prosecutorial discretion context as in the public employment context."[84]

4. Application to SEC Administrative Proceedings

As discussed above, under governing Supreme Court doctrine, class of one equal protection claims may be brought in certain circumstances. Defendants who believe the SEC singled them out to face administrative action while others in similar situations were funneled to federal court have seized upon the doctrine. At present, no court has ruled on whether class of one claims are available in this context, much less weighed in on the merits of such a claim. From one perspective, the choice of forum could be described as a form of discretionary authority and thus would constitute an improper basis for a class of one suit. On the other hand, it could be argued that the SEC has a "default" path towards federal court and that deviating from that path in a small number of cases is exactly the type of conduct that *Olech* and *Engquist* allow to be challenged.

81 United States v. Moore, 543 F.3d 891, 893 (7th Cir. 2008).

82 *Id.* at 901 (quoting *Engquist*, 553 U.S. at 602).

83 *Id.*

84 *Id.*

III. THE EQUAL PROTECTION DEBATE REGARDING SEC ADMINISTRATIVE PROCEEDINGS

A. Overview of the Ongoing Debate

Taking together the various challenges to SEC administrative proceedings, there is a core argument that arises repeatedly. The defendants argue that the SEC's decision is not guided by any statute, regulation, or pattern of practice.[85] They point to numerous protections that are available in federal court and not in the administrative proceedings.[86] The individuals challenging the SEC's conduct suggest that the decision to subject them to an administrative hearing while other similar defendants receive all the protections of federal court lacks any justification and unfairly disadvantages them.[87] They argue that, under the class of one doctrine, they may seek redress for equal protection violations stemming from the SEC's actions.[88]

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85 *See, e.g.*, Jarkesy Complaint, *supra* note 42, at 7; Chau Complaint, *supra* note 49, at 4.

86 *See, e.g.*, Gupta Complaint, *supra* note 26, at 7–8; Peixoto Complaint, *supra* note 56, at 23–24.

87 *See, e.g.*, Gupta Complaint, *supra* note 26, at 7–8; Jarkesy Complaint, *supra* note 42, at 9; Chau Complaint, *supra* note 49, at 4; Peixoto Complaint, *supra* note 56, at 21–24.

88 It should be noted that equal protection challenges are not the only constitutional attacks defendants have made against SEC administrative proceedings. The cases discussed above have also raised other claims like improper infringement on the right to jury trial. *See, e.g.*, Brief for Appellants at 5, Jarkesy v. SEC, 803 F.3d 9 (D.C. Cir. 2015) (No. 14-5196). Additionally, recent challenges have begun raising Article II concerns. *See, e.g.*, Complaint at 13–15, Stillwell v. SEC, No. 14-cv-7931 (S.D.N.Y. filed Oct. 1, 2014); Complaint at 13–21, Bebo v. SEC, No. 15-cv-0003, 2015 WL 905349 (E.D. Wis. Mar. 3, 2015) [hereinafter Bebo Complaint]. Those cases argue that SEC ALJs are executive officers under Article II and that they are unconstitutionally shielded from removal by multiple layers of protection. *See, e.g.*, Bebo Complaint at 20. Such challenges certainly raise further concerns about SEC administrative proceedings and lend additional weight to calls for reform, but their legal arguments are beyond the scope of this Note.

The core issue for defendants seeking to challenge SEC administrative proceedings on equal protection grounds will be determining which one of the categories of decisions described in *Engquist* corresponds with the SEC's forum decision. If there is a clear standard against which deviations can be evaluated, as in *Olech*, then class of one equal protection claims should be available. However, if the decision of forum is more akin to a subjective and discretionary decision, like the employment decisions in *Engquist*, such class of one claims might fail.

B. Critiques of SEC Conduct in Selecting Forums for Enforcement Actions

To date, courts have not addressed the merits of these equal protection challenges, but there is strong cause for concern about abuses of equal protection rights. Defendants raising such claims admittedly face long odds. Each court will engage in a fact-specific inquiry and defendants are unlikely to prevail absent particularly compelling evidence in their favor. Not all of the defendants discussed above necessarily have winning arguments and many of the challenges certain to be brought in the future might fall short. However, evidence that twenty-eight similar individuals faced a different forum[89] or that only three out of 156 similar cases have gone through administrative proceedings[90] would lend credibility to these types of claims. This evidence is especially convincing given the significant differences between administrative proceedings and actions in federal court[91] and the complete absence of explanation for the SEC's forum decisions. When an agency can subject one individual to significantly different treatment than others in the same situation without any stated reason, the potential for unconstitutional conduct is high. Discretion can stretch only so far and deference to discretionary decisions should

89 Gupta v. SEC, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011)

90 Peixoto Complaint, *supra* note 56, at 21.

91 *See* Coffee, *supra* note 13.

not be allowed to mask violations of core constitutional rights.

This criticism is not to say that the SEC should never make use of the administrative proceedings, as Dodd-Frank empowered it to do. What is clear, however, is that the SEC's use of its power in a manner that may infringe on the equal protection rights of some defendants is a cause for concern. Even people affiliated with the SEC have acknowledged that complaints about the current system have merit. Anne K. Small, General Counsel of the SEC, while emphasizing that she was speaking for herself and not for the Commission, agreed at a recent event that suggestions for updating the rules governing administrative proceedings were "entirely reasonable."[92] She acknowledged that the rules had not been updated in some time and stated that "[w]e want to make sure the process is fair and reasonable, so [changing] procedures to reflect the changes makes a lot of sense."[93] At a conference, Commissioner Michael Piwowar stated that "[t]o 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."[94] Indeed, by mid-2015, the SEC began to take steps to update its procedures and establish guidelines regarding the use of administrative proceedings.[95] As discussed in Part IV of this Note, however, these steps fail to do enough to address many of the concerns expressed by defendants and other critics.

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92 *See* Daniel Wilson, *SEC Administrative Case Rules Likely Out of Date, GC Says*, LAW360 (June 17, 2014), http://www.law360.com/articles/548907/sec-administrative-case-rules-likely-out-of-date-gc-says [http://perma.cc/69BP-PD7R].

93 *Id.* (alteration in original).

94 Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, 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 [http://perma.cc/YVN9-XVLZ].

95 See discussion *infra* Parts IV.A, IV.B.

Perhaps the most prominent and vocal critic of SEC administrative proceedings is Judge Rakoff of the Southern District of New York. As noted above, in his *Gupta* ruling, Judge Rakoff seemed sympathetic to the defendant's equal protection argument.[96] Though that case was dismissed prior to any ruling on the merits of the equal protection claim, Judge Rakoff continues to express his concerns about the SEC's conduct in this area. At a November 2014 event, he "suggested that the SEC's administrative proceedings might be unfair to litigants, damage the SEC's reputation and even stunt the development of the federal securities laws."[97] He has wondered from where the "constitutional warrant for such unchecked and unbalanced administrative power" derives.[98] It is safe to assume that many defendants and members of the defense bar share Judge Rakoff's concerns.

In July 2015, the United States Chamber of Commerce published a report through its Center for Capital Markets Competitiveness, which recommended changes to SEC enforcement practices.[99] It set forth twenty-eight proposals to "provide clarity to market participants and eliminate unnecessary ambiguity."[100] In particular, it suggested reforms to establish a structure for the choice of forum that incorporates due process protections.[101] The report urged the SEC not to consider what forum was in its own best interest, but instead to ground its decision in objective criteria consistent with its broader mission.[102]

96 *See* discussion of Rakoff's ruling *supra* Part II.B.1.

97 *See* Nicolas Berg et al., *SEC's Continued Use of Administrative Forum Irks Critics, Raises Sticky Constitutional Questions*, CORP. L. & ACCOUNTABILITY REP., Dec. 19, 2014, at 1722 (discussing Judge Rakoff's remarks).

98 *Id.*

99 CTR. FOR CAPITAL MKTS. COMPETITIVENESS, EXAMINING U.S. SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT: RECOMMENDATIONS ON CURRENT PROCESSES AND PRACTICES (2015), http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf [http://perma.cc/U7Y9-JXDB].

100 *Id.* at 8.

101 *Id.* at 11–21.

102 *Id.* at 18.

C. Defenses of the Current SEC Procedures

Of course, not everyone sees things the way Judge Rakoff and many defendants do. At the same November 2014 event at which Judge Rakoff spoke, the head of the SEC Enforcement Division, Andrew Ceresney, insisted that no unfair advantage exists in the administrative forum.[103] Later that month, Ceresney argued at another event that the SEC's "use of the administrative forum is eminently proper, appropriate, and fair to respondents."[104] A different SEC official has maintained that "there's nothing unjust or unfair about administrative proceedings" and that the proceedings provide "unique due process rights" comparable to those in a criminal case.[105]

The SEC can make a strong argument that the decision regarding how to pursue civil remedies against alleged wrongdoers is a matter appropriately left to the discretion of the agency.[106] SEC officials have reminded detractors that "the Supreme Court has upheld the constitutionality of administrative proceedings."[107] The SEC emphasizes that the administrative route is often a much more efficient way to resolve an enforcement action.[108] In other words, the administrative proceedings are simply "another tool in [the SEC's] toolbox" that has been "underutilized for a period of time."[109]

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103 *See* Berg et al., *supra* note 97, at 1772 (discussing Nov. 7, 2014 remarks).

104 *Id.* at 1773 (quoting Nov. 21, 2014 statements).

105 *See* Stephen Joyce, *SEC to Use Administrative Cases More, Despite Defense Bar Complaints, Officials Say*, CORP. L. & ACCOUNTABILITY REP., Nov. 14 2014, at 1504–05 (discussing statements by Charles Cain, Deputy Chief of the SEC's Foreign Corrupt Practices Act Unit).

106 *See* Engquist v. Or. Dep't of Agric., 553 U.S. 591, 602–03 (2008) (barring class of one claims based on truly discretionary actions).

107 Joyce, *supra* note 105, at 1505 (quoting SEC Foreign Corrupt Practices Act Unit head, Charles Cain).

108 *Id.* (describing comments by SEC Enforcement Division Director, Andrew Ceresney).

109 *See* Phyllis Diamond, *SEC's Hawke Defends Admin. Forum for Insider Cases*, CORP. COUNS. WKLY., Oct. 22, 2014, at 323 (describing

As one high-level SEC official explained, "[i]n every case you make judgments about which forum is most advantageous for the interests of your client."[110] According to that official, before deciding on a forum, the SEC performs "an extensive risk analysis" that takes into account the "trade-offs" associated with each option.[111] This begins to sound much like the kind of decision that "by [its] nature involve[s] discretionary decisionmaking based on a vast array of subjective, individualized assessments."[112] Under *Engquist*, such discretionary decisions cannot serve as the basis for class of one equal protection suits. Allowing challenges to decisions of this sort "would undermine the very discretion that such state officials are entrusted to exercise."[113] If employment decisions are sufficiently discretionary to prevent class of one claims, the SEC can argue that courts should grant decisions about how to enforce securities law a similar status. At least one ALJ has agreed and ruled that "'class of one' claims are unavailable in federal civil enforcement proceedings."[114]

In *Chau*, Judge Kaplan—though he did not rule on the merits of the defendant's equal protection claim—conceded that concerns about the current system are "legitimate." Yet he also expressed some skepticism about the equal protection argument, observing that "[i]n the time-honored and entirely appropriate way of so many litigants, [defendants and their counsel] usually want a particular forum, and deride alternatives, for no reason more exalted than self-interest. They seek the forum that they believe, rightly or wrongly,

statements by Daniel Hawke, Chief of the market abuse unit of the SEC Enforcement Division).

110 *Id.*

111 *Id.*

112 Engquist v. Or. Dep't of Agric., 553 U.S. 591, 603 (2008).

113 *Id.*

114 Harding Advisory LLC, Admin. Proc. Rulings Rel. No. 1252, 2014 SEC LEXIS 606, at *5 (Feb. 19, 2014) (citing United States v. Am. Elec. Power Serv. Corp., 258 F. Supp. 2d 804, 808 (S.D. Ohio 2003)).

would be more likely to find in their favor."[115] Even more bluntly, Judge Kaplan described his "serious doubts about whether plaintiffs' 'superficial comparisons' are sufficient to allege plausibly a 'class of one' claim, particularly as to the SEC's discretionary choice of the forum in which to bring charges."[116]

United States v. Moore, discussed above, provides additional support for the view that challenges to SEC administrative proceedings are without merit.[117] As the court explained, "discretion conferred on prosecutors in choosing whom and how to prosecute is flatly inconsistent with a presumption of uniform treatment. Indeed, in this context, there is no readily apparent standard against which departures can be assessed for arbitrariness."[118] Though *Moore* predates Dodd-Frank and does not deal directly with SEC administrative proceedings, its logic may apply to the types of challenges discussed in Part II.B. From the perspective of the SEC's defenders, the decision about which forum to use lacks fixed guideposts and instead varies based on a host of factors and considerations. Though not true "prosecutions," these enforcement actions function in much the same way and a strong argument can be made that they should be treated the same.

D. Concluding Thoughts on the Debate

Despite the defenses of the SEC noted above, there remains a compelling argument that the decision regarding forum is comparable to the type of decision described in *Olech*. The Court there noted that, despite the general subjectivity involved in zoning decisions, the village did not appear to determine easement sizes in an individualized

115 Chau v. SEC, 72 F. Supp. 3d 417, 436 (S.D.N.Y. 2014). *But see* Greene, *supra* note 4 (noting remarks by a former SEC assistant director and current defense lawyer that "[w]hen a regulatory or law enforcement agency finds a tool that works well, they use it").

116 *See Chau*, 72 F. Supp. 3d at 435 n.148.

117 United States v. Moore, 543 F.3d 891 (7th Cir. 2008).

118 *Id.* at 901.

matter.[119] Instead, fifteen-foot easements were routinely required until the town deviated from that norm in responding to Olech's request.[120] Likewise, the SEC undoubtedly exercises a great deal of discretion in conducting its affairs; the enforcement of securities law generally involves a degree of subjectivity. Yet, just as the zoning decisions in *Olech* departed from the typical subjectivity and operated in a seemingly automatic and non-individualized way, the forum decisions by the SEC arguably lack many markers of truly discretionary or particularized thought. The SEC's routine course of action for the types of cases discussed above is to go through federal court, but it deviates from that course for certain defendants like those discussed above.[121]

Ultimately, there is a strong argument that the SEC's conduct in the types of cases discussed above is more like that in *Olech* than that in *Engquist*. Individuals like Gupta, Jarkesy, Chau, and Peixoto should be able to bring equal protection challenges against the SEC's choice of forum under the class of one doctrine. Certainly, the merits of their equal protection claims will turn on the unique facts of each case. Some of those raising objections might not prevail. Courts might conclude that there are significant distinctions between receiving treatment different from four other individuals and treatment different from more than twenty other individuals.[122] In many instances, the SEC might have legitimate reasons for its decision to choose one forum over another. As matters stand now, though, there are valid concerns that need to be addressed.

Paradoxically, the SEC's stated intention to make greater use of administrative proceedings might eventually make these equal protection complaints less common and harder to

119 Village of Willowbrook v. Olech, 528 U.S. 562, 602–03 (2000) (per curiam).

120 *Id.*

121 *See supra* Part II.B.

122 *Compare* Chau v. SEC, 72 F. Supp. 3d 417 (S.D.N.Y. 2014), *with* Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y 2011).

sustain.[123] Class of one challenges require a showing that the individual was treated differently from those similarly situated.[124] Those, like Rajat Gupta, who face administrative proceedings alone while dozens of others are pursued in federal court can make a compelling argument under that precedent.[125] The success of the recent spate of equal protection claims depends on the relative rarity of the administrative option at present. If the SEC shifts more and more cases to that forum, it will be harder for defendants to point to skewed numbers to back their challenges. Until the selection of the administrative forum becomes routine, equal protection challenges are likely to continue. Indeed, even if the majority of enforcement is funneled through the administrative route, individuals are still likely to be suspicious of the decision about which forum to use and the SEC will still have the capacity to jeopardize constitutional rights. Regardless of the frequency with which the administrative forum is utilized, interests in transparency and fairness support the call to reform the current selection procedures and policies.

IV. REFORMING SEC FORUM CHOICE PRACTICES

In order to alleviate the substantial and growing concern about protecting individuals from unconstitutional treatment through the SEC's choice of forum, the government must consider reforms to the existing policies and procedures. The success of any given class of one equal protection challenge will depend on the facts of that particular case, but the potential for rights violations is clear. Under the current system, the standard practice is for the SEC to pursue enforcement against individuals in federal court.[126] Although the SEC intends to make greater use of its Dodd-Frank

123 *See* Berg et al., *supra* note 97, at 1773 (noting statements by an SEC official that "administrative proceedings were 'the new normal' for the SEC and would be used 'more frequently'").

124 *See* Engquist v. Or. Dep't of Agric., 553 U.S. 591, 602 (2008).

125 *See Gupta*, 796 F. Supp. 2d at 514.

126 *See* Cohen et al., *supra* note 20; Chan et al., *supra* note 12, at 2.

power to pursue remedies administratively, those actions remain the exception to the general practice.[127]

Given that the SEC enjoys a higher success rate in administrative proceedings than in federal court[128] and that its shift towards using more administrative proceedings corresponds with a string of losses in federal court,[129] it is hard not to share the above concerns raised by defendants. The administrative proceedings begin to look like a home court that places defendants in a worse position than similar defendants who receive the protections of federal court.[130] As long as the SEC can take either path without a word of explanation, the door remains open to decisions that are arbitrary, irrational, or motivated by improper animus and which violate constitutional rights. To alleviate the valid concerns of defendants and the defense bar (and to hopefully reduce the number of class of one challenges brought against the SEC), modifications to the status quo should be considered.

A. Potential Reforms to the Rules Governing SEC Administrative Proceedings

One potential area for reform is the administrative proceedings themselves. The crux of the class of one challenges discussed above is that defendants are unfairly

127 *See* Cohen et al., *supra* note 20; Chan et al., *supra* note 12, at 2.

128 *See* Berg et al., *supra* note 97, at 1773 ("Although the SEC prevailed in 61 percent of its federal cases in the 12 months prior to September 2014, it won every case heard before an ALJ during the same period.").

129 *Id.* ("[T]he timing of the SEC's decision to pursue more insider trading cases administratively is difficult not to view as an attempt to stack the deck in light of its recent prominent losses . . . .").

130 The SEC has achieved fourteen consecutive victories in cases contested before an ALJ, while its "record in its 20 trials in federal court since October 1, 2013 is 7 victories, 7 losses, and 6 mixed verdicts." Bruce Carlton, *SEC Riding Lengthy Unbeaten Streak in Administrative Proceedings*, COMPLIANCE WEEK (Jan. 20, 2015), http://www.complianceweek.com/blogs/enforcement-action/sec-riding-lengthy-unbeaten-streak-in-administrative-proceedings [http://perma.cc/R4SF-8E4D].

forced to bear burdens not present in federal court actions.[131] By adopting reforms to the policies and rules governing SEC administrative proceedings, the differences between the two forum options could be lessened and the perception of inequity reduced.[132] As one commentator has written, the "SEC understandably wants to win more of its cases. But if the price is to reduce fairness, both justice and the SEC's credibility will suffer."[133] That author suggested reforms including additional time for defendants to prepare their cases, expanded discovery, independent judges, and more robust evidence rules.[134] These are the same types of shortcomings defendants identified in the cases discussed above in Part II.B. Such changes would help to ensure more equal treatment between the two forums.

One reform worth particular consideration is allowing additional time for defendants in administrative proceedings. The SEC's current Rules of Practice provide only 300 days from commencement of the charges for the ALJ to file an initial decision with the Commission.[135] This results in an extremely expedited timeline[136] whereby defendants frequently receive only a few months to review massive numbers of documents.[137] In contrast, the

131 *See* discussion *supra* Part II.B.

132 The administrative proceedings are guided by the SEC's Rules of Practice. 17 C.F.R. § 201.100–.900 (2014).

133 *See* Cohen et al., *supra* note 20, at 2.

134 *Id.*

135 17 C.F.R. § 201.360 (2014).

136 *See id.* (noting that under the 300-day timeline, the hearing will take place approximately four months after the initiation of the administration proceeding).

137 In *Jarkesy*, for example, the defendant alleges that he received an investigative file from the SEC that included over 700 gigabytes of data, or "between 15 and 25 million pages of unorganized, un-indexed, and often mislabeled documents." Brief for Appellants at 10–11, Jarkesy v. SEC, 803 F.3d 9 (D.C. Cir. 2015) (No. 14-5196). Worse still, in *Chau*, the defendant allegedly received more than 11.5 terabytes of data—"an amount of data that, in printed form, would exceed the entire printed library of Congress." Chau Complaint, *supra* note 49, at 12. He argued that he would be able to review at most 1.1 percent of the documents under the schedule imposed in the administrative proceeding. *Id.*

government might spend a year or more building its case, so this brief and rigid timeline can present real limits on the thoroughness of the defense.

Several obvious downsides arise, however, with regard to this type of reform. First and foremost, major procedural changes are unlikely to take hold and might prove difficult to implement.[138] Efforts to drastically rework the operation of administrative proceedings might encounter substantial opposition. Any changes by the SEC to its Rules of Practice would be subject to the provisions of the Administrative Procedure Act.[139] Furthermore, by bringing the two forums more in sync with one another, reforms might eliminate the distinctive advantages of each. For example, there might well be cases where an expedited 300-day schedule imposes no burdens and is perfectly appropriate. Tweaking the system too much might undermine the efficiency gains that administrative proceedings offer. The decision as to which forum to utilize must be fair, but there are certainly benefits to having options.

Nevertheless, in a significant development, the SEC proposed changes to its Rules of Practice in October 2015.[140] Although the SEC did not acknowledge that the changes were related to the frequent criticisms of its administrative proceedings,[141] it is hard to imagine the response is not designed in part to combat those attacks. Indeed, many of the proposals address the deficiencies raised in the cases discussed in Part II.B of this Note. For example, after complaints about the limited discovery in administrative proceedings, the proposed changes would allow for three to

138 On the other hand, the SEC has previously proposed amendments to its Rules of Practice "as a result of the Commission's experience with its existing rules." *See, e.g.*, Adoption of Amendments to the Rules of Practice, Exchange Act Release No. 52846, 2005 WL 3199273 (Dec. 5, 2005).

139 Whether reforms would be subject to the provisions of the Administrative Procedure Act requiring notice, opportunity for public comment, and publication would depend on whether they relate to "agency organization, procedure, or practice" under 5 U.S.C. § 553(b)(3)(A) (2014).

140 *See* Proposed Amendments, *supra* note 17.

141 *See* Henning, *supra* note 18.

five depositions per side.[142] Similarly, in the face of criticism about the rapid pace at which administrative proceedings proceed, the SEC proposal would allow up to eight months after the initiation of a proceeding before a hearing must commence.[143] The SEC also proposes giving ALJs an optional extension of the deadline to issue a decision.[144]

These changes are a step in the right direction and help to ease the burdens faced by individuals subjected to administrative proceedings. Administrative proceedings, however, will continue to differ substantially from litigation in federal court. While it is promising to see the SEC responding to the concerns raised about its use of administrative proceedings, the overarching criticisms raised by many defendants remain. Furthermore, the SEC in its proposal "tucked in a few goodies for itself"—such as favorable rules about the use of hearsay evidence[145]—which work to undermine progress in the defendants' desired direction.

The proposed amendments to the Rules of Practice will remain open for comment until December 4, 2015. However, unless the SEC makes significant revisions in light of public comment, the amendments will amount to only a small move in the right direction, not a satisfying resolution of the issues raised in this Note.

Another recent development in this ongoing debate is Representative Scott Garrett's introduction in October 2015 of a bill called the Due Process Restoration Act of 2015.[146] Rather than reform the administrative proceedings, this bill aims to "substantially curtail" their use by raising the burden of proof and allowing defendants an opportunity to

142 *See* Proposed Amendments, *supra* note 17, at 60,092.

143 *See id.*

144 *See id.*

145 *See* Henning, *supra* note 18.

146 Peter J. Henning, *Reforming the S.E.C.'s Administrative Process*, N.Y. TIMES (Oct. 26, 2015), http://www.nytimes.com/2015/10/27/business/dealbook/reforming-the-secs-administrative-process.html [http://perma.cc/LZ8F-4WVS].

request termination of the proceeding.[147] One observer commented that this proposal "does not address issues about the fairness of the process so much as make it sufficiently unattractive that it would keep cases away from administrative judges."[148] Whether this proposal will gain any traction remains to be seen and many might criticize its harsh effect. More incremental reform focusing on creating greater parity between federal court and administrative proceedings—while maintaining some of the advantages of each—might prove preferable and easier to achieve.

B. Potential Reforms that Encourage Greater Transparency Behind Forum Choices for SEC Enforcement Actions

Another potential avenue for reform, perhaps more attractive given the disadvantages present in the first, is to focus on increasing the transparency behind the process of selecting a forum. Such a reform has the advantage of being smaller in scope and thus is more likely to take hold and be implemented quickly.

The SEC Rules of Practice indicate that proceedings are to be initiated by an Order Instituting Proceedings.[149] The rules specifically address the contents of those orders, requiring a statement of the "nature of any hearing," the "legal authority and jurisdiction," the "matters of fact and law to be considered," and the "nature of any relief or action sought or taken."[150] Many of the concerns addressed in this Note could be remedied by mandating minor additions to the SEC Rules of Practice to require the SEC to state its reasons for choosing the administrative forum. For example, an amendment could be added to Section 201.200(b) to require "a brief and plain statement of the Commission's reasons for instituting proceedings administratively rather than in federal court."

147 *Id.*

148 *Id.*

149 17 C.F.R. § 201.200 (2014).

150 17 C.F.R. § 201.200(b) (2014).

There are few drawbacks to such minor revisions to the rules governing administrative proceedings and the benefits are potentially large. True, some element of secrecy will be stripped from the workings of the SEC, but that is a relatively minor concession when balanced against important equal protection rights. As noted above, officials with the SEC have repeatedly defended administrative proceedings as fair[151] and stated that—behind the scenes—the SEC engages in a careful assessment that balances a range of concerns and interests.[152] In particular, the SEC has highlighted the expertise and specialized knowledge of securities law that SEC ALJs possess and the efficiency of the administrative forum compared to federal court proceedings.[153] In an interview, the director of the SEC Enforcement Division explained that the agency considers questions such as:

> What is the nature of the subject matter? Does the case involve complex securities industry issues? What charges are being brought and what relief is sought? Is there a need for prompt resolution to protect investors or return funds to injured victims? Has there been a waiver of privilege? Would there be other public benefits from quick results?[154]

These types of considerations almost certainly satisfy the constitutional requirement that "[w]hen those who appear similarly situated are nevertheless treated differently[,]" the government must have "at least a rational reason for the difference."[155] It does not seem too much of a burden to remove some of the shroud of mystery around the SEC's

151 *See supra* note 104 and accompanying text.

152 See *supra* notes 110–111 and accompanying text.

153 *See* Andrew M. Lawrence, Erich T. Schwartz & Cory C. Black, *Aggressive SEC Enforcement Approach Creates New Challenges for Resolving Investigations*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES (Jan. 2015), https://www.skadden.com/insights/aggressive-sec-enforcement-approach-creates-new-challenges-resolving-investigations [https://perma.cc/MNF8-V57E].

154 *See* Greene, *supra* note 4.

155 Engquist v. Or. Dep't of Agric., 553 U.S. 591, 602 (2008).

decisions and provide a public explanation for the choice of forum.

The skepticism regarding the SEC's conduct and the recent surge in lawsuits challenging this conduct both feed upon the lack of transparency behind the SEC's decision-making process. It is understandable that lawsuits and criticism will arise when one person is subjected to entirely different treatment than twenty-eight other individuals in similar circumstances without any explanation as to why.[156] Admittedly, lawsuits are likely to continue even if the SEC is required to provide an explanation for its forum decision at the outset of administrative proceedings, but such a change would help stem the flow.

At the very least, reforms that require disclosure of SEC rationales will simplify the resolution of any litigation that does arise. The parties are expending enormous amounts of time, energy, and resources in the disputes discussed above. Many of these cases involve arguments and decisions in administrative courts, separate lawsuits in federal court, dismissals on jurisdictional grounds, and appeals of those jurisdictional decisions.[157] At some point, some federal court will hear the challenges on their merits and make a ruling. That ruling, in turn, will likely be appealed. Meanwhile, other cases in other districts and other circuits will continue to grapple with the same questions.

This all amounts to a massive amount of litigation just to arrive at a fairly straightforward fact-specific inquiry that will focus on finding a "rational reason" for the disparate treatment of one individual.[158] In all but the most extraordinary of cases, a proper and rational reason for the SEC's conduct will exist and class of one equal protection claims will fall short. Much time and effort can be saved—and much discovery can be prevented—if the SEC provides a statement of its forum choice rationale in the initial Order Instituting Proceedings. This will deter the rare instances

156 Gupta v. SEC, 796 F. Supp. 2d 503, 514 (S.D.N.Y. 2011).

157 *See supra* Part II.B.

158 *Engquist*, 553 U.S. at 602.

when the SEC might otherwise have engaged in questionable conduct. It also will provide judges an easy means to resolve disputes that do arise because reasons provided by the SEC will qualify almost without fail as "rational reasons." Any court that agrees with the analysis of this Note that class of one equal protection claims can theoretically be maintained in SEC forum choice cases will be able to quickly assess the merits of such a claim.

Significantly, in May 2015, the SEC's Division of Enforcement posted a document called "Division of Enforcement Approach to Forum Selection in Contested Actions."[159] This document set forth factors the Division considers when making a forum recommendation to the Commission. Specifically, the Division said it considers: (1) "The availability of the desired claims, legal theories, and forms of relief in each forum"; (2) "Whether any charged party is a registered entity or an individual associated with a registered entity"; (3) "The cost-, resource-, and time-effectiveness of litigation in each forum"; and (4) "Fair, consistent, and effective resolution of securities law issues and matters."[160] These factors largely mirror the types of considerations SEC officials have previously cited in public comments.[161]

Although this document provides greater clarity, several problems remain. First, the Division of Enforcement was careful to stress that the factors it provided were not exhaustive.[162] Those facing an SEC enforcement action still do not have a clear picture of all the considerations motivating the SEC's forum choice. Second, technically, the document states only the factors the Division of Enforcement considers in making its recommendations to the Commission. Defendants are still left guessing about what

159 *Division of Enforcement Approach to Forum Selection in Contested Actions*, SEC. & EXCH. COMM'N, http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf [http://perma.cc/UC3A-F429].

160 *Id.*

161 *See supra* Part III.C.

162 *See* SEC. & EXCH. COMM'N, *supra* note 159.

exactly the Commission itself considers when making a final determination about forum.[163]

Thus, while some have praised the Division of Enforcement's document as "an important step in responding to the debate over the proper use of its administrative proceedings,"[164] more remains to be done. The release addresses a key issue in equal protection claims—"whether the SEC had a legitimate, rational basis for treating the defendants differently by choosing different forums"—but still leaves the burden on defendants to go out and "search for inconsistencies."[165] Requiring the SEC to specifically state how it believes the cited factors weigh in each particular case would provide greater transparency and clarity. It would allow parties and the public to understand the SEC's decisions and would reduce needless litigation.

The SEC has vigorously contested cases that bring equal protection attacks against its decision to initiate administrative enforcement actions. It is likely justified in its strenuous efforts; it seems improbable that the SEC is actually violating the constitutional rights of individuals through its conduct, except perhaps in rare cases. Yet as long as the SEC's decisions are shrouded in mystery, concern is likely to linger. Rather than continue to fight lawsuits of this type, the SEC should make reforms that provide greater insight into its forum decisions. If it shows that it engaged in a reasoned analysis of various factors, it will succeed in making its actions look more like the type of discretionary decision that cannot be pursued in class of one claims under *Engquist*[166]—or, at the very least, succeed in showing that

163 *See* CTR. FOR CAPITAL MKTS. COMPETITIVENESS, *supra* note 99, at 14 ("As it is a Division Statement, it is not clear whether it has been reviewed by the Commission, and as such it should not be viewed as the indication of what factors the Commission itself will consider when a Division recommendation is submitted.").

164 Joel M. Cohen & Bennett Rawicki, *Welcome News from the SEC on Forum Selection*, NAT'L L.J., June 1, 2015.

165 *Id.*

166 Engquist v. Or. Dep't of Agric., 553 U.S. 591, 595 (2008).

its conduct had a rational basis that would defeat such claims.

V. CONCLUSION

Dodd-Frank significantly expanded the authority of the SEC to make use of its administrative forum. In recent years, the SEC has enthusiastically seized upon this new authority.[167] The result has been a string of cases that claim equal protection violations under the class of one theory. The defendants in those cases argue that their rights are infringed upon when the SEC singles them out for different treatment than others receive.[168] Courts have not yet addressed the core equal protection debate, but the defendants have a strong argument that class of one cases should be permitted so as to ensure that the SEC is acting with a rational basis when it subjects defendants to an administrative proceeding. Given the valid concerns about threats to constitutional rights, the SEC would be well advised to consider reforms. Relatively minor steps could drastically increase the transparency behind the SEC's decisions and help to curb the perception that the SEC is seeking a home court advantage that results in unfair treatment of a small number of defendants. Requiring an articulation in each case of the reasons for choosing one forum over the other will make the legal issues discussed in this Note easier to resolve and will also promote greater public confidence in the conduct of the SEC.

167 *See* Mahoney, *supra* note 19.

168 *See* discussion *supra* Part II.B.