

The SEC's Proposed Modernization of Its Rules for Administrative Proceedings

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White Collar

Last week, the Securities and Exchange Commission proposed extensive changes to the rules governing administrative proceedings it brings to enforce the federal securities laws. Administrative proceedings are heard by in-house SEC administrative law judges (ALJs)—with no opportunity for a jury trial—rather than in federal court. Most notably, the proposed rule amendments would provide for new discovery tools and more time to prepare for hearings. The SEC said its proposals are intended to “modernize” administrative proceedings by “introduc[ing] additional flexibility..., while still providing for the timely and efficient disposition of proceedings.”¹ The SEC made these proposals against a backdrop of constitutional challenges and other public critiques of the fairness of its administrative proceedings.

SEC administrative proceedings are more important than ever. Today, under the Dodd-Frank Act, the SEC may require *anyone* to be tried in the administrative forum, which is no longer limited to firms and individuals in the securities industry or otherwise regulated by the SEC. Respondents have no say in the SEC’s choice of venue. The SEC has recently been exploiting its authority under Dodd-Frank to bring a greater variety of enforcement actions administratively rather than in federal court. Respondents who lose administrative proceedings face the prospect of severe SEC sanctions, potentially including financial penalties, disgorgement, officer-and-director bars, and corporate monitors.

The most fundamental change proposed by the SEC would expand the availability of depositions in administrative proceedings. Currently, a party may ask an ALJ for permission to take a deposition only if the witness will be unable to attend or testify at the hearing. See SEC Rule of Practice 233(b). The new rule would also permit both sides in complex cases to notice depositions of witnesses regardless of their expected availability at the hearing. In a proceeding against a single respondent, the respondent and the SEC Division of Enforcement could each notice up to three depositions; in multi-respondent cases, each side could notice no more than five depositions. The rule would require the respondents to notice the depositions “collectively,” but does not provide any standard or mechanism for resolving disagreements among them over, for example, the identity of the deponents or whose counsel would take the lead in questioning them. ALJs would have no discretion to authorize additional depositions based on the scope or complexity of the SEC’s allegations; the number of respondents; the degree to which respondents’ interests diverge from one another; or the number of important witnesses whose testimony the SEC staff did not take during their investigation.

¹ SEC Press Release 2015-209 (statement of SEC Chair Mary Jo White) (Sept. 24, 2015); SEC Proposed Rules, Release No. 34-75976, at 3 (Sept. 24, 2015). Both of these documents may be found at <http://www.sec.gov/news/pressrelease/2015-209.html>.

The SEC's proposal would also increase the availability of document discovery. Under the existing rules, beyond obtaining access to the SEC staff's investigative file, document discovery is limited to subpoenaing documents for the hearing. See SEC Rules of Practice 230 and 232. The new rule would permit parties to subpoena documents not in the investigative file and question witnesses about them before the hearing. See Proposed Rule 233(d). The SEC's proposal does not indicate the permissible breadth of pre-hearing document discovery.

To allow time for discovery and for respondents to review electronic documents, the SEC's proposed rules would authorize ALJs to give the parties in complex cases up to four additional months. The current rule directs ALJs to schedule hearings in all but the simplest cases to begin approximately four months after the service of the SEC's changing the document. The amended rule would give ALJs discretion to enlarge that period, but only to a maximum of eight months. Thus, under the SEC's proposals for complex multi-respondent cases, the defense would have no more than eight months to review an extensive investigative record (typically including millions of electronic communications and other documents), participate in as many as ten depositions, draft expert reports, attend pre-hearing conferences, brief dispositive and any other motions, prepare for a lengthy hearing, and submit pre-hearing briefs.

In our view, the SEC's proposals are a step in the right direction, but would not ensure fairness to respondents in complex administrative proceedings. The SEC staff can investigate a case for years, collect mountains of documents, and take testimony from as many witnesses as they wish, yet respondents who face potentially ruinous sanctions have limited discovery rights and are tried within months. Moreover, under the expanded powers the SEC received in the Dodd-Frank Act, the agency has nearly unlimited discretion to bring individual administrative proceedings against multiple respondents alleging numerous violations spanning many years and involving highly complex facts and voluminous documents. If the agency makes full use of these powers, there will inevitably be cases in which arbitrary limits to the number of depositions and hearing preparation time will deprive respondents of a fair opportunity to defend themselves. The rules should give ALJs full flexibility to provide fairness in all cases. We expect that this theme, along with many other useful suggestions, will be developed in comments by members of the public submitted during the 60-day comment period for the SEC's proposal.

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