

CORPORATE AND SECURITIES LITIGATION

Expert Analysis

SEC Adopts Amendments to Rules For Administrative Proceedings

As we discussed in our April 2016 column,¹ one major feature of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was that it expanded the SEC's jurisdiction and authorized the agency to impose civil money penalties in administrative proceedings against anyone who violated the federal securities laws.² Before Dodd-Frank, the SEC could bring such proceedings only against a regulated entity or an individual associated with one. In our previous column, we examined some of the constitutional and other challenges brought against this administrative scheme. Here, we review a raft of changes to the way those administrative proceedings are conducted.

The SEC enjoys many procedural advantages when pursuing actions before its own administrative law judges (ALJs)—limited discovery disclosures, liberal evidentiary rules, no jury, and an internal appeals process. In recent years, the defense bar has complained increasingly that



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the SEC's administrative proceedings do not offer adequate discovery and that respondents are rushed to trial without sufficient time to prepare a meaningful defense. These

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significant disadvantages for respondents, combined with reports suggesting the SEC enjoys a higher win rate in administrative hearings than in federal court, support the widespread view that the SEC has a "home field advantage" before its own tribunals.

In response to this growing criticism, on July 13, 2016, the SEC approved amendments to its Rules of Practice "intended to update the rules and introduce additional flexibility into administrative proceedings, while continuing to provide for the timely and efficient resolution of the proceedings."³ In announcing the proposed amendments last fall, SEC Chair Mary Jo White explained that the amendments "seek to modernize our rules of practice for administrative proceedings, including provisions for additional time and prescribed discovery for the parties."⁴

But during the period of public comment following the proposal, many argued that the amendments did not go far enough to guarantee respondents a fair and impartial hearing.⁵ The SEC's final amended rules respond to some, but not all, of those criticisms. We highlight here some of the key amendments to the Rules of Practice and the impact they may have on the SEC's administrative proceedings.

Extension of Timeline

Amended Rule 360 extends the prehearing period to permit respondents more time to prepare for their

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administrative hearings. Under the former Rule 360, the time between service of an order instituting proceedings (OIP) and the ALJ's initial decision was limited to 120, 210, or 300 days, depending on the "nature, complexity, and urgency of the subject matter."⁶ In a complex 300-day case, the hearing would commence within approximately four months of the OIP, leaving respondents just six months to review the mounds of evidence collected by the SEC. Hearings commenced within 75 days from the OIP in 210-day cases, and 30 days in 120-day cases.

The SEC adopted three amendments to Rule 360. First, the clock for the ALJ to issue the initial decision now runs from when parties complete post-hearing briefing, rather than when the action was initiated. Second, the revised rule extends the length of the prehearing period to a maximum of 10 months for 300-day complex proceedings, six months for 210-day cases, and four months for 120-day cases. Third, the ALJ may request from the commission an additional 30 days to issue an initial decision.

Although respondents will have more time to prepare their cases, the disparity between the parties is still large. Ten months is a relatively short period for respondents to prepare for a complex trial, particularly where the SEC has had years to investigate, collect documentary evidence, and take testimony.

Deposition Discovery

Former Rule 233 allowed parties to take depositions only for witnesses unavailable to testify at the hearing and only with the ALJ's permission. Amended Rule 233 allows for limited

deposition discovery in complex cases to "facilitate the development of the case during the prehearing state, which may ultimately result in more focused prehearing preparations, with issues distilled for the hearing and post-hearing briefing."⁷ Each side may notice three depositions in a single-respondent case, and five depositions in a multi-respondent action. Depositions of unavailable witnesses do not count against the parties' limit, and require the ALJ's permission.

Under the former Rule 320, all evidence was admissible in administrative proceedings unless it was "irrelevant, immaterial, or unduly repetitious." Amended Rule 320(b) adds "unreliable" evidence to the excluded categories.

In response to public comment urging the commission to allow more discovery depositions, the final amended Rule 233(a)(3) permits each side to request an additional two depositions from the ALJ. Also in response to public comment, the SEC extended the maximum length of each deposition to seven hours, rather than the six-hour limit initially proposed. However, respondents in 30-day or 75-day proceedings remain unable to take discovery depositions.

Admissibility of Evidence

Under the former Rule 320, all evidence was admissible in administrative proceedings unless it was "irrelevant, immaterial, or unduly

repetitious." Amended Rule 320(b) adds "unreliable" evidence to the excluded categories, but hearsay testimony is still permitted so long as it is "relevant, material, and bears satisfactory indicia of reliability so that its use is fair."⁸ Although these amendments are more permissive than the Federal Rules of Evidence, the commission reasoned that they are consistent with the Administrative Procedure Act.⁹

Rule 235 provides the standard for granting a motion to introduce a prior sworn statement of a non-party witness. The amended rule permits parties, upon a motion, to introduce deposition testimony, investigative testimony, or certain sworn declarations. In deciding the motion, the hearing officer will evaluate the admissibility and relevance of the statement, the availability of the witness for the hearing, and the general presumption favoring live testimony. Of significant concern to respondents, amended Rule 235 may be interpreted to permit the SEC to offer investigative testimony that has not been subject to cross-examination.

Limited Expert Disclosures

Amended Rule 222 limits the information that a party must disclose regarding its expert, making the rule more similar to Federal Rule of Civil Procedure 26(b). The rule requires a party calling an expert witness to provide a brief summary of the expert's expected testimony, a statement of the expert's qualifications, a list of other proceedings in which the expert has opined during the previous four years, and a list of publications authored by the expert during the previous 10 years. Notably, amended Rule 222(b)

(2) protects from disclosure all drafts of an expert's report and most communications between counsel and the expert.

Contents of an Answer

Amended Rule 220 requires a respondent to disclose in its answer to an OIP whether the respondent is asserting any "reliance" defenses, such as reliance on advice of counsel, accountants, auditors, or other professionals, in connection with any claim, violation alleged, or remedy sought. Failure to do so may be deemed a waiver.

Summary Dispositions

Former Rule 250 allowed a party to move for summary disposition (like summary judgment under Federal Rule of Civil Procedure 56) after a respondent answered the OIP, but only once the SEC produced its discovery. Initially, the commission did not propose to amend Rule 250, but ultimately decided to do so in response to a commenter's suggestion that respondents should be allowed to challenge the SEC's "legal theories...as of right" prior to the hearing.¹⁰

Amended Rule 250 provides three types of dispositive motions that may be filed at different stages of the administrative proceeding, which are analogous to the motion protocols in federal court. First, a party may move for a ruling on the pleadings no later than 14 days after a respondent's answer has been filed.¹¹ Second, any party may move for summary disposition on one or more claims or defenses after a respondent's answer has been filed. Leave of the hearing officer to file a summary disposition motion is required in 120-day proceedings. Third, without need for permission

from the hearing officer, any party may move for judgment as matter of law following the SEC's presentation of its case-in-chief.¹²

What's Next

The amendments become effective on Sept. 27, 2016, and will apply to all proceedings initiated on or after that date. Some amended rules will apply to pending cases depending on the stage that the action has reached.¹³

Although the SEC's changes to its Rules of Practice are a step in the right direction, critics maintain that the reforms do not go far enough to level the playing field, nor do they eliminate respondents' due process concerns. While providing additional safeguards, the amendments fall short of the broad procedural protections that defendants are afforded in federal court. As this article goes to press, the U.S. Court of Appeals for the D.C. Circuit has issued its decision in *Raymond James Lucia Cos. v. SEC*, upholding the constitutionality of the SEC's in-house administrative courts.¹⁴ With that avenue of challenge narrowing, it will be interesting to see how respondents use the amended Rules of Practice to raise due process concerns in future cases and appeals.

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1. Margaret A. Dale and Mark D. Harris, "SEC Enforcement Actions Before Administrative Tribunals," NYLJ, April 13, 2016.

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

3. SEC Press Release, "SEC Adopts Amendments to Rules of Practice for Administrative Proceedings," July 13, 2016, available at <https://www.sec.gov/news/pressrelease/2016-142.html>; see also Amendments to the Commission's Rules of Practice, Exchange Act Release No. 34-78319, 81 Fed. Reg. 50,212 (July 29, 2016) (to be codified at 17 CFR pt. 201).

4. SEC Press Release, "SEC Proposes to Amend Rules Governing Administrative Proceedings," Sept. 24, 2015, available at <http://www.sec.gov/news/pressrelease/2015-209.html>; see also Proposed Amendments to the Commission's Rules of Practice, Exchange Act Release No. 34-75976, 80 Fed. Reg. 60,091 (Oct. 5, 2015).

5. See Comments on Proposed Rule: Amendments to the Commission's Rules of Practice, available at <https://www.sec.gov/comments/s7-18-15/s71815.shtml>.

6. In designating time frames for administrative proceedings, the commission "considers 'the nature, complexity, and urgency of the subject matter,' with due regard for the public interest and the protection of investors." 81 Fed. Reg. 50,214 (quoting 17 CFR 201.360(a)(2)(i)). Generally, administrative proceedings instituted pursuant to §12(j) of the Exchange Act are designated as 120-day cases, administrative proceedings seeking sanctions as a result of an injunction or conviction are designated as 210-day cases, and administrative proceedings alleging violations of the securities laws are designated as 300-day cases.

7. 80 Fed. Reg. at 60,092-93.

8. 81 Fed. Reg. at 50,226.

9. See 5 USC §556(c)(3) (allowing hearing officers to receive relevant evidence); 5 USC §556(d) (stating that a sanction may not be imposed or rule or order issued except on consideration of the whole record or of those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence); see also 5 USC §556(d) (stating that any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial or unduly repetitious evidence).

10. 81 Fed. Reg. 50,223, at n.108.

11. This is comparable to a motion to dismiss under Federal Rules of Civil Procedure 12(b) (6) ("failure to state a claim upon which relief can be granted") and 12(c) (judgment on the pleadings).

12. This is analogous to Federal Rule of Civil Procedure 50(a) (judgment as a matter of law).

13. See 81 Fed. Reg. 50,228-30.

14. *Raymond James Lucia Cos. v. SEC*, No. 15-1345 (D.C. Cir. Aug. 9, 2016).