

ALI-ABA LIVE VIDEO WEBCAST
SEC AND STATE ENFORCEMENT AND LITIGATION
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DEFENDING AN SEC ADMINISTRATIVE PROCEEDING

© October 1, 2008 Christian J. Mixer¹

- I. In General
 - A. Think of an A.P. like a bench-trying criminal case -- that's what it most closely resembles procedurally (except for burden of proof, which is preponderance of the evidence²), and that's how your client will view it if his/her license is on the line.
 - B. As soon as it is instituted by the Commission, an A.P. will be referred to an Administrative Law Judge ("ALJ"), who will hear the evidence and initially decide the case. Although the ALJ is a Commission employee whose decision can be reviewed *de novo* by the SEC, winning before the ALJ is possible, and very important.³
 - C. There are two distinct kinds of A.P.s that are prosecuted by the Division of Enforcement:

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² See *Steadman v. SEC*, 450 U.S. 91, 102 (1981). Another difference that would be striking to criminal practitioners is the fact that the Division of Enforcement may call your client to testify in its case in chief. See, e.g., *In the Matter of Joseph Catapano*, Init. Dec. Rel. No. 300, 2005 SEC LEXIS 2939 (Nov. 10, 2005).

³ One of the reasons that the ALJ's initial decision is important is that the law judge, unlike the Commission, actually sees the witnesses testify, and the Commission normally will not second-guess the ALJ's assessment of credibility. See, e.g., *In the Matter of Robert Thomas Clawson*, Exchange Act Rel. No. 48143 at 3, 2003 SEC LEXIS 1598 at *7 (July 9, 2003) ("We accept a fact finder's credibility finding absent overwhelming evidence to the contrary"); *In the Matter of Brian A. Schmidt*, Exchange Act Rel. No. 45330 at n.5, 2002 SEC LEXIS 180 at n.5 (Jan. 24, 2002); *In the Matter of Laurie Jones Canady*, Exchange Act Rel. No. 41250, 1999 SEC LEXIS 669 at *27 (April 5, 1999) ("As we have consistently held, 'credibility determinations by an initial fact finder are entitled to considerable weight [and] can be overcome only where the record contains 'substantial evidence' for doing so.'"). However, the Commission will not always defer to the ALJ's credibility determinations. See, e.g., *In the Matter of Kenneth R. Ward*, Exchange Act Rel. No. 47535 at 11-12, 2003 SEC LEXIS 687 at *41-*42 (March 19, 2003).

1. “Original” A.P.s, in which the ALJ is required to consider whether the respondent broke the law at all;
2. “Follow-on” A.P.s, in which the only issue is whether an already-existing injunction or criminal conviction against the respondent should lead to a further sanction such as revocation or suspension of a license.

Respondents historically have been able to win a number of “original” A.P.s; in “follow-on” proceedings, which ALJs never dismiss outright, the only practical upside for a respondent is a light sanction. The Commission has made life hard for a respondent in a “follow-on” A.P. based on an SEC injunction, by ruling that such a respondent cannot contest the allegations that were contained in the SEC’s complaint in the injunctive case. *See, e.g., In the Matter of Marshall E. Melton, et al.*, Exchange Act Rel. No. 48228, Investment Advisers Act Rel. No. 2151 at 8-10, 2003 SEC LEXIS 1767 at *22-*30 (July 25, 2003); *see also In the Matter of Harold F. Harris, et al.*, Exchange Act Rel. No. 53122A at 9 n.21, 2006 SEC LEXIS 68 (Jan. 13, 2006) (noting possible exception for injunction entered on default if the respondent lacked a full and fair opportunity to litigate the issues in the district court).

- D. Procedure in SEC A.P.s is governed by the Commission’s own Rules of Practice, 17 C.F.R. §§ 201.100 *et. seq.*, which perform basically the same function as the Federal Rules of Civil Procedure.⁴
- E. Effective July 17, 2003, the Commission adopted rules under which each A.P., at institution, is to be designated to be completed at the ALJ level within 120 days, or 210 days, or 300 days.⁵ Each overall limit comes with sublimits for the prehearing, briefing, and decisional phases, as follows:

⁴ The Rules of Practice are reprinted in 15 U.S.C.A. following Section 78u, and are available on the SEC’s Website at www.sec.gov/litigation. In this outline, the Rules are cited simply by their three-digit number.

⁵ For a discussion of the Commission’s 2003 scheduling rules, *see* Christian J. Mixter, *The SEC’s New Administrative Proceedings Rules*, INSIGHTS, Sept. 2003, p. 1. In *In the Matter of Gregory M. Dearlove, CPA*, Exchange Act Rel. No. 57244, AAER No. 2779 at 49-57, 2008 SEC LEXIS 223 (Jan. 31, 2008), the Commission considered and, unsurprisingly, rejected a respondent’s due process challenge to its scheduling rules.

**Overall
Limit**

Sublimits

	<i><u>Until Hearing (Pretrial)</u></i>	<i><u>Transcript Preparation and Briefing</u></i>	<i><u>Decision by ALJ</u></i>
120 days	1 month	2 months	1 month
210 days	2.5 months	2 months	2.5 months
300 days	4 months	2 months	4 months ⁶

So far, the SEC has largely reserved the 120-day track for proceedings aimed at suspending or revoking the registration of stock where the issuer had failed to file annual or periodic reports – a type of administrative action in which little serious resistance by most respondents would be expected. The 210-day track has thus far been reserved for “follow-on” A.P.s (see I(C) above). All other proceedings have been put on the 300-day track.

- F. Do not count on getting “routine” extensions of time – an additional rule change in 2003 was the adoption of a policy that the ALJs and the Commission shall “strongly disfavor” requests for extensions unless the moving party makes a strong showing that denial of the request would substantially prejudice his or her case. *See* Rule 161(b); *see, e.g., In the Matter of Gregory M. Dearlove, CPA*, Init. Dec. Rel. No. 315 at 64-66, 2006 SEC LEXIS 1684 (July 27, 2006).
1. The 2003 scheduling rules also may have taken their toll on the ALJs’ willingness to tolerate litigation tactics, by either the Division or respondents, that the ALJ perceives as lazy or dilatory. *See In the Matter of John A. Carley*, Init. Dec. Rel. No. 292 at 32-33, 47, 2005 SEC LEXIS 1745 (July 18, 2005).
- G. Bring all your trial skills to the hearing room. An A.P. hearing is, first and foremost, a trial. In view of the tightness of the new scheduling rules, pretrial preparation should begin *before* the Order Instituting Proceedings is issued.
- H. Stay alert to settlement possibilities as you learn more about the Division’s case and as you develop your client’s case. The settlement that seemed out of reach when the case was first brought may come within your grasp as the case progresses.⁷

⁶ Rule 360(a)(2). Under Rule 360(a)(3), the Chief Administrative Law Judge may move for an extension of the presiding ALJ’s time to issue the initial decision. *See In the Matter of Laminaire Corp. (n/k/a Cavico Corp.)*, Exchange Act Rel. No. 56912, 2007 SEC LEXIS 2827 (Dec. 5, 2007).

⁷ The 2003 A.P. scheduling rules somewhat encourage mid-proceeding settlements by providing a more relaxed standard for delay if one or more respondents offers to settle and wishes for the proceeding to be stayed while the Commission considers his or her settlement offer (see Rule 162(c)). In 1998 the

II. Significant Prehearing Milestones

A. **Respondent's Answer (Rule 220).** Due within 20 days after service of the Order Instituting Proceedings. Like an answer in federal district court, the answer in an A.P. is an important but largely technical document. Histrionics in an answer are a waste of time, may unnecessarily alert the Division to your strategy at the hearing, and may gratuitously supply impeachment material at the hearing. Aim toward simple denials (or, if appropriate, "d.k.i."s or admissions).

1. But remember that *you must assert specifically "[a] defense of res judicata, statute of limitations or any other matter constituting an affirmative defense," or else that defense is waived* (Rule 220(c)). See *Canady v. SEC*, 230 F.3d 362 (D.C. Cir. 2000).
2. A motion for a more definite statement is permitted, and may be granted, see *In the Matter of J.W. Barclay & Co., Inc.*, Admin. Proc. Rulings Rel. No. 599, 2002 SEC LEXIS 1638 (June 13, 2002), but it does not toll the time to answer -- rather, it is to be filed "with an answer" (Rule 220(d)).
3. There is no real counterpart, under the SEC's Rules of Practice, to a Fed.R.Civ.P. 12(b)(6) motion to dismiss the proceeding -- the closest equivalent is a motion for summary disposition under Rule 250, which is more like a summary judgment motion under Fed.R.Civ.P. 56 in that it is to be made "[a]fter a respondent's answer has been filed and, in an enforcement or disciplinary proceeding, documents have been made available to that respondent for inspection and copying."⁸
 - a. If you think about it for a moment, it would in any event be a bit of a long shot to ask the ALJ to dismiss on its face the Order Instituting Proceedings that the full Commission just issued.⁹

SEC issued an Alternative Dispute Resolution Policy Statement, Exchange Act Rel. No. 40306, 1998 SEC LEXIS 1653, which suggests (but hardly encourages) the possibility of mediation in enforcement actions, including A.P.s.

⁸ The standard governing a motion for summary disposition appears to be the same -- whether the opponent of the motion has raised a genuine issue of material fact -- that applies to a motion for summary judgment under Fed.R.Civ.P. 56. See, e.g., *In the Matter of Roger M. De Trano*, Init. Dec. Rel. No. 242 at 2-3, 2003 SEC LEXIS 2867 at *3-*5 (Dec. 4, 2003); *In the Matter of Joseph P. Galluzzi*, Init. Dec. Rel. No. 187, 2001 SEC LEXIS 1582 (Aug. 7, 2001), *aff'd*, Exchange Act Rel. No. 46405, 2002 SEC LEXIS 2202 (Aug. 23, 2002).

⁹ A notable, but short-lived, exception to this statement was Chief Judge Murray's decision *In the Matter of Ernst & Young LLP*, Admin. Proc. Rulings Rel. No. 600, 2002 SEC LEXIS 1892 (July 2, 2002), *vac.*, Exchange Act Rel. No. 46710, 2002 SEC LEXIS 2714 (Oct. 23, 2002), dismissing an administrative proceeding on the ground that it was instituted without a quorum. See also *In the Matter of E Trade Systems, Inc.*, Init. Dec. Rel. No. 301, 2005 SEC LEXIS 3137 (Nov. 29, 2005) (dismissing

- b. According to ALJ Kelly, an OIP can plead alternative (and inconsistent) theories of liability, so long as the Division chooses one form of relief when the time is “ripe” – presumably, after the hearing. *See In the Matter of Amaroq Asset Management, LLC*, Init. Dec. Rul. Rel. No. 351 n.12, 2008 SEC LEXIS 1612 n.12 (July 14, 2008).
4. The Commission’s Rules now include a provision allowing a respondent in a multi-respondent case to move to sever. Rule 201(b). Such a motion must be directed to the Commission (not the ALJ), and must represent that “a settlement offer is pending before the Commission” or “otherwise show good cause.” The Commission is not particularly receptive to respondents’ severance motions that are made under the “good cause” standard. *See In the Matter of David A. Finnerty, et al.*, Exchange Act Rel. No. 56756, 2007 SEC LEXIS 2588 (Nov. 6, 2007); *In the Matter of John A. Carley*. Exchange Act Rel. No. 50954, 2004 SEC LEXIS 1 (Jan. 3, 2005); *In the Matter of John A. Carley*. Exchange Act Rel. No. 50695, 2004 SEC LEXIS 2645 (Nov. 18, 2004).¹⁰
5. There is one other, somewhat specialized circumstance in which a respondent in a multi-respondent proceeding may be able to separate his/her hearing from that of his/her fellow respondents. Exchange Act Section 21C(b), 15 U.S.C. § 78u-3(b), gives a respondent in a cease-and-desist proceeding the right to demand a hearing within 60 days of the OIP. If the other respondents don’t join in that demand, it likely will provoke the Division of Enforcement either to drop its prayer for cease-and-desist order against the respondent who demanded the early hearing, or to agree to a severance. The latter response is, of course, more likely if the Division

proceeding where the Division attempted to substitute a totally different respondent for the respondent named in the OIP).

In a less-than-evenhanded touch, SEC administrative practice allows the Division of Enforcement to make the equivalent of a Fed.R.Civ.P. 12(f) motion to strike legally insufficient defenses from a respondent’s Answer to the Order Instituting Proceedings. *See, e.g., In the Matter of Piper Capital Management, Inc.*, Admin. Proc. Rulings Rel. No. 577, 1999 SEC LEXIS 301 at *4-*11 (Jan. 15, 1999). Such motions by the Division are *not* always granted, *see In the Matter of J.W. Barclay & Co., Inc.*, Admin. Proc. Rulings Rel. No. 599, 2002 SEC LEXIS 1638 (June 13, 2002); moreover, the ALJ may choose to “carry” a motion to strike through the hearing and rule on it after the evidence is in. *See In the Matter of Dean Witter Reynolds Inc.*, Init. Dec. Rel. No. 179, 2001 SEC LEXIS 99 at *2 (Jan. 22, 2001).

¹⁰ Consolidation of separately-instituted A.P.s is also possible where appropriate to avoid unnecessary cost or delay. *See* Rule 201; *In the Matter of Lawrence A. Campbell*, Admin. Proc. Rul. Rel. No. 634, 2007 SEC LEXIS 1068 (May 21, 2007).

is only seeking cease-and-desist relief against the respondent who makes the demand.¹¹

- B. The Prehearing Conference(s) (Rule 221).** In 1998 the Commission amended Rule 221 to provide that only one prehearing conference is required in an A.P.¹² Nevertheless, normally it is desirable to ask for more. The ALJ will usually schedule a conference shortly after the respondent's answer is filed. Practically anything about the proceeding is open for discussion.¹³ From the respondent's perspective the most important goals in an initial conference are building credibility, setting the timing of the hearing and as detailed a prehearing schedule as you think it useful to have (including asking the ALJ to order the Division to provide the "pretrial order"-type materials that are listed in Rule 222), and learning as much as possible about the ALJ's hearing practices (e.g., requiring that the direct exams of experts be submitted in writing).
1. As noted above, if the Order Instituting Proceedings seeks a cease and desist order (and in the somewhat unlikely event that it's in your client's interest to force an early hearing), remember that you have the right to demand that the hearing take place no later than 60 days after service of the OIP. *See* Exchange Act Section 21C(b).
 2. If you haven't already been getting documents from the Division under Rule 230 (see C below) by the time of the initial prehearing conference,

¹¹ This scenario is partially illustrated by *In the Matter of Trautman Wasserman & Co., Inc., et al.* In that case, the New York Attorney General intervened in the proceeding and got the proceeding stayed pending the outcome of a New York criminal case involving some of the respondents and witnesses. One of the respondents, Barbera, moved for a hearing within sixty days on the Division's claim against him for a c&d, which was one of several types of relief that the Division sought. In response, the Division filed a motion with the Commission to dismiss the cease-and-desist proceeding against Barbera, leaving in place the other prayers for relief against him. *See* Exchange Act Rel. No. 55989, 2007 SEC LEXIS 1408 (June 29, 2007) (Commission order dismissing Barbera's petition for interlocutory review, in which he argued that the entire proceeding against him, and not just the claim for a c&d, should have been dismissed because of alleged misconduct by Division counsel). The *Trautman* matter also illustrates the limitations on this tactic in a case where the respondent is faced with additional claims over and above the c&d -- in the end, Barbera settled to a c&d, a six-month suspension from associating with a broker or dealer and a six-month associational bar on the investment company/investment adviser side, and a \$60,000 penalty. *See SEC v. Mark Barbera*, Lit. Rel. No. 20458, 2008 SEC LEXIS 340 (Feb. 14, 2008).

¹² Unless all parties agree that it is unnecessary or undefined "important considerations" make it "inappropriate," one prehearing conference is mandatory and may not be dispensed with simply because the ALJ and the Division conclude that it is superfluous. *See In the Matter of Jose P. Zollino*, Exchange Act Rel. No. 51632 at 5, 2005 SEC LEXIS 987 (April 29, 2005).

¹³ Rule 221(a) states that the purposes of a prehearing conference "include, but are not limited to: (1) Expediting the disposition of the proceeding; (2) Establishing early and continuing control of the proceeding by the hearing officer; and (3) Improving the quality of the hearing through more thorough preparation."

this is a good time to bring that up. Consider whether you want to ask for interim conferences to ensure that you get what you're entitled to.

3. Remember, though, that you too, and not just the Division, will be held to any "pretrial order"-type deadlines that are set as part of the prehearing conference process. *See In the Matter of Abraham and Sons Capital, Inc.*, Exchange Act Rel. No. 44624 at 9-10, 2001 SEC LEXIS 1522 at *31-32 (July 31, 2001).

C. Document Discovery from the Division (Rules 230, 231).

1. Starting no later than seven days after service of the Order Instituting Proceedings, the Division must give you access to most of the investigative file:¹⁴
 - a. Basic Documents That the Division Must Produce (Rule 230(a)) --
 - (i) each subpoena issued;
 - (ii) every other written request to persons not employed by the Commission to provide documents or to be interviewed;
 - (iii) the documents turned over in response to any such subpoenas or other written requests;
 - (iv) all transcripts and transcript exhibits;
 - (v) any other documents obtained from persons not employed by the Commission;
 - (vi) any final examination or inspection reports prepared by the Office of Compliance Inspections and Examinations, the Division of Market Regulation, or the Division of Investment Management if the Division intends to introduce them into evidence or to use them to refresh a witness's recollection.¹⁵

¹⁴ Rule 230 defines the documents to be produced as "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." In a ruling that is likely to inhibit the future use of "omnibus" formal orders in industry-wide investigations, an administrative law judge has held that Rule 230 sweeps in all documents produced by anyone pursuant to such an omnibus order. *See In the Matter of Michael Sassano*, Securities Act Rel. No. 8865, Exchange Act Rel. No. 56874, Investment Advisers Act Rel. No. 2679, Investment Company Act Rel. No. 28070, 2007 SEC LEXIS 2779 (Nov. 30, 2007) (denying the Division's petition for interlocutory review of disclosure order).

¹⁵ A respondent who wishes to review the investigative file must be given the opportunity to do so. *See In the Matter of Jose P. Zollino*, Exchange Act Rel. No. 51632 at 5, 2005 SEC LEXIS 987 (April 29, 2005).

- b. Documents That the Division May Withhold -- The Division is authorized by Rule 230(b) to withhold documents that are privileged; internal Commission memoranda, notes or writings; documents that are covered by the work product protection and will not be offered into evidence; documents that would disclose the identity of a confidential source; and other documents that the ALJ grants leave to withhold.
 - i. *Always request a “withheld document list” under Rule 230(c).* The ALJ is likely to order the Division to provide one if you ask, and if you don’t ask you will have no idea what you aren’t getting. The Commission’s rules now permit this list to identify documents by category rather than by individual document, subject to the discretion of the ALJ to order a more particularized list.
 - ii. The Staff will not be permitted to creatively design new “privileges” and withhold documents based on those “privileges.” *See In the Matter of Putnam Investment Management, LLC*, Admin. Proc. Rulings Rel. No. 614, 2004 SEC LEXIS 865 (April 7, 2004).
- 2. Exculpatory (“*Brady*”) Material. This is handled very oddly in the SEC’s Rules. Rather than saying affirmatively that a respondent is entitled to *Brady* material, Rule 230(b)(2) states that “Nothing in this paragraph (b) authorizes the Division of Enforcement in connection with an enforcement or disciplinary proceeding to withhold, contrary to the doctrine of *Brady v. Maryland*, 373 U.S. 83, 87 (1963), documents that contain material exculpatory evidence.”
 - a. Nevertheless, Rule 230(b)(2) is treated in practice as granting full-fledged *Brady* rights. It’s worth asking separately for *Brady* material, even if the response you get is that anything *Brady* has already been produced.¹⁶
 - b. While you’re asking for *Brady* material, ask specifically for any documents that fall under the related *Giglio/Bagley* principle, which requires the Government in a criminal case to produce

¹⁶ For illustrations of how *Brady* issues can play out in SEC A.P.s, see *In the Matter of Warren Lammert*, Securities Act Rel. No. 8833, Exchange Act Rel. No. 56233, Investment Advisers Act Rel. No. 2629, Investment Company Act Rel. No. 27927, 2007 SEC LEXIS 1779 (Aug. 9, 2007); *In the Matter of KPMG Peat Marwick L.L.P.*, Exchange Act Rel. No. 43862, AAER No. 1360, 2001 SEC LEXIS 98 at *74 n.90 (Jan. 19, 2001); *In the Matter of Orlando Joseph Jett*, 52 S.E.C. 830, 1996 SEC LEXIS 1683 (1996); *In the Matter of City of Anaheim*, Admin. Proc. Rulings Rel. No. 586, 1999 SEC LEXIS 1662 (July 30, 1999); *In the Matter of Piper Capital Management, Inc.*, Admin. Proc. Rulings Rel. No. 577, 1999 SEC LEXIS 301 (Jan. 15, 1999).

documents in its possession that would serve to impeach the Government's witnesses. *See United States v. Bagley*, 473 U.S. 667, 676 (1985); *Giglio v. United States*, 405 U.S. 150 (1972).

3. Prior Statements by Division Witnesses (“*Jencks*” Material) (Rule 231). You may (and should) request these documents from the Division; make the request early -- for example, at the initial prehearing conference.
 - a. *Timing.* Although Rule 231 invokes the Jencks Act, which provides that the Government need not produce a *Jencks* statement until “[a]fter a witness called by the United States has testified on direct examination,” 18 U.S.C. § 3500(b), the Comment to Rule 231 makes clear that you can get *Jencks* materials from the SEC before the hearing begins, and probably well before that.
 - b. Don’t be surprised when the Division claims that they have no *Jencks* material apart from any transcripts already produced under Rule 230(a)(1)(iv). The Commission’s rules now adopt the definition of “statement” contained in the Jencks Act.¹⁷

D. Other Document Discovery (Rule 232). Rule 232 permits any party to an A.P. to ask the ALJ to issue witness subpoenas returnable at the hearing; significantly, however, the rule goes on to say that “subpoenas requiring the production of documentary or other tangible evidence [may be] returnable at any designated time or place.” *This means that Rule 232 subpoenas can be used to get prehearing document discovery.* Rule 232 subpoenas may be issued to anyone.

1. “Anyone” includes Commission employees. *See* Comment (a) to Rule 230 (“Rule 230 is not the exclusive means by which a respondent may obtain access to or production of documents. Production of documents prepared by the staff ... may be sought by subpoena pursuant to Rule 232”). If you believe that the Commission has documents apart from what is in the investigative file that will help your client defend an A.P., ask the ALJ to issue a subpoena for them.
 - a. However, make a targeted request. Although the standard of relevance is broad, *see In the Matter of Putnam Investment Management, LLC*, Admin. Proc. Rulings Rel. No. 614, 2004 SEC

¹⁷ *See* 18 U.S.C. § 3500(e). The statutory definition of “statement” is “(1) a written statement made by said witness and signed or otherwise adopted or approved by him; (2) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital of an oral statement made by said witness and recorded contemporaneously with the making of such oral statement; or (3) a statement, however taken or recorded, or a transcription thereof, if any, made by said witness to a grand jury.” The Jencks Act (as distinct from Fed. R. Crim. P. 26.2) contains no “reciprocal Jencks” obligation, and there is no such obligation upon respondents in SEC APs. *See In the Matter of Gregory M. Dearlove*, Admin. Proc. Rul. Rel. No. 623, 2005 SEC LEXIS 3370 (Dec. 21, 2005).

LEXIS 865 (April 7, 2004), “kitchen sink” subpoenas tend to get quashed, or greatly narrowed, even by ALJs who are philosophically inclined toward granting discovery. *See In the Matter of Steven Altman, Esq.*, Admin. Proc. Rul. Rel. No. 640, 2008 SEC LEXIS 965 (April 30, 2008); *In the Matter of Mitchell M. Maynard*, Admin. Proc. Rul. Rel. No. 643, 2008 SEC LEXIS 1469 (June 27, 2008); *In the Matter of Asset Equity Group, Inc.*, Admin. Proc. Rul. Rel. No. 616 (Jan. 28, 2005); *In the Matter of Jean-Paul Bolduc*, Admin. Proc. Rulings Rel. No. 590, 1999 SEC LEXIS 2441 (Oct. 20, 1999); *In the Matter of WHX Corporation*, Admin. Proc. Rulings Rel. No. 580, 1999 SEC LEXIS 617 (March 9, 1999), *modifying In the Matter of WHX Corporation*, Admin. Proc. Rulings Rel. No. 579, 1999 SEC LEXIS 619 (March 9, 1999).

- b. Also, at least one ALJ has ruled that Rule 232 subpoenas may not be used to gather expert discovery outside the discovery that is otherwise permitted by the Rules. *See In the Matter of Lawrence A. Stoler, CPA*, Admin. Proc. Rul. Rel. No. 628, 2006 SEC LEXIS 1058 (May 10, 2006).

2. Motions to quash can be made by the recipient of the subpoena, the “owner, creator, or the subject of the documents that are to be produced,” or any party to the proceeding (Rule 232(e)(1)). In making an application to quash, the moving party must provide sufficient specifics about such issues as burden and privilege to avoid denial of the application as “perfunctory.” *See In the Matter of Brendan E. Murray*, Admin. Proc. Rul. Rel. No. 632, 2007 SEC LEXIS 108 (Jan. 9, 2007).

E. **Prehearing Depositions (Rule 233).** Like criminal cases in federal district court, SEC A.P.s do *not* allow for discovery depositions. The depositions that are permitted under Rule 233 are strictly what used to be called “de bene esse” or “evidence” depositions, which are trial-type examinations of witnesses who cannot be called to testify at the hearing. *See Comment to Rule 233* (“Depositions under the Rules of Practice are used only to preserve testimony of a witness who would be unlikely to be able to attend the hearing. They are not allowed for purposes of discovery.”). *See generally In the Matter of David Henry Disraeli*, Securities Act Rel. No. 8824, Exchange Act Rel. No. 56045, Investment Advisers Act Rel. No. 2618, 2007 SEC LEXIS 1514 (July 11, 2007).

1. Procedure: if you want to take a Rule 233 deposition, you must make a motion to the ALJ, who then must find that the prospective witness has material evidence to give and “that it is likely the prospective witness, who is then within the United States, will be unable to attend or testify at the hearing because of age, sickness, infirmity, imprisonment, other disability, or absence from the United States unless it appears that the absence of the witness was procured by the party requesting the

deposition; and that the taking of a deposition will serve the interests of justice.” Rule 233(b).

2. “Geographical inconvenience” within the United States normally is not a sufficient reason why a witness should be permitted to testify by deposition rather than live at the hearing. *But see In the Matter of Fundamental Portfolio Advisors, Inc.*, Init. Dec. Rel. No. 180 at n. 16, 2001 SEC LEXIS 156 at n.16 (Jan. 29, 2001), *aff’d*, Securities Act Rel. No. 8251, Exchange Act Rel. No. 48177, Investment Advisers Act Rel. No. 2146, Investment Company Act Rel. No. 26099, 2003 SEC LEXIS 1654 (July 15, 2003). Subpoenas for hearing testimony under Rule 231 may be served nationwide (see Exchange Act Section 21(b), 15 U.S.C. § 78u(b)), and if witness convenience is a serious issue, the ALJ will often hold part or all of the hearing at a place convenient to the parties and witnesses. Another possibility is to move that an otherwise-unavailable witness be permitted to testify by telephone. *See In the Matter of Christopher A. Lowry*, Init. Dec. Rel. No. 190 at n.1, 2001 SEC LEXIS 1839 at n.1 (Sept. 14, 2001).

a. *Caveat.* If you fail to request a deposition of a witness who becomes less available at the time of the hearing than before (for example, because of a wasting illness), the ALJ may hold that failure against you when you try to get the testimony into the hearing record by alternative means (as, for example, by telephone). *See In the Matter of Dean Witter Reynolds Inc.*, Init. Dec. Rel. No. 179, 2001 SEC LEXIS 99 at *10 n.8, *15 n.13 (Jan. 22, 2001).

F. **Motion for Summary Disposition (Rule 250).** Summary disposition motions by the Division have become a favored way for ALJs to move their dockets under the 2003 scheduling rules, particularly in Section 12(j) deregistration proceedings and in “follow-on” A.P.s *See In the Matter of Jose P. Zollino*, Init. Dec. Rel. No. 308 at 4, 2006 SEC LEXIS 475 (March 2, 2006) (citing cases); *see also In the Matter of Conrad P. Seghers*, Investment Advisers Act Rel. No. 2656 at 8, 2007 SEC LEXIS 2238 (Sept. 26, 2007) (“For a follow-on proceeding, summary disposition may be inappropriate in certain rare circumstances, when ‘a respondent may present genuine issues with respect to facts that could mitigate his or her misconduct,’” *quoting John S. Brownson*, 55 S.E.C. 1023, 1028 n.12 (2002), *aff’d*, 66 Fed. Appx. 687 (9th Cir. 2003)). Such motions are also technically available to respondents under the Rules, but are rarely granted. *Cf. In the Matter of Rita Villa*, Exchange Act Rel. No. 39518, AAER No. 1005, 1998 SEC LEXIS 3 at *10-12 (Jan. 6, 1998). *But see In the Matter of Salvatore F. Sodano*, I.D. Rel. No. 333, 2007 SEC LEXIS 1847 (Aug. 20, 2007); *In the Matter of Information*

Architects Corp., Init. Dec. Rel. No. 299, 2005 SEC LEXIS 2764 (Oct. 25, 2005) (dismissing case based on cross-motions for summary disposition).¹⁸

- G. **The Final Pretrial Conference.** This is your last clear chance to convince the ALJ to require the Division to produce any of the Rule 222 prehearing submission items to which you believe that you are entitled. As indicated in B(2) above, however, you should *not* wait until a final pretrial conference to make your first request for those materials.

III. The Hearing

A. The hearing is a trial -- nothing more, nothing less.

B. There are a few differences, some substantive and some superficial

1. Substantive Differences

- a. Individual ALJs have practices that may affect how you try your case -- for example, requiring that direct examinations of expert witnesses be submitted in written form, so that the expert's first "live" testimony is on cross. (As previously noted, the time to smoke these out is at the prehearing conference(s).)
- b. On evidentiary matters, the ALJs tend to be guided by the Federal Rules of Evidence, although hearsay can be admitted,¹⁹ and the ALJs have been directed by the Commission to err on the side of admitting evidence, particularly where the objection goes to relevance. *See, e.g., In the Matter of the City of Anaheim*, Exchange Act Rel. No. 42140, 1999 SEC LEXIS 2421 (1999); *In the Matter of Laurie Jones Canady*, Exchange Act Rel. No. 41250, 1999 SEC LEXIS 669 at *27 n.24 (1999); *In the Matter of WSF Corp.*, Init. Dec. Rel. No. 204 at 4-5, 2002 SEC LEXIS 1242 at *8-

¹⁸ A motion for summary disposition under Rule 250 also can do service as a directed verdict-type motion at the close of the Division's case, and in fact is the only vehicle recognized under the Rules for such an application. *See In the Matter of Rita Villa*.

¹⁹ The Commission has held that in appropriate circumstances, hearsay may even form the sole basis for findings of fact. *See In the Matter of Edgar B. Alacan*, Exchange Act Rel. No. 49970 at 14, 2004 SEC LEXIS 1422 (July 6, 2004). "The Commission evaluates the probative value, reliability, and the fairness of its use by examining, among other things, 'the possible bias of the declarant; whether or not the statements are contradicted by direct testimony; the type of hearsay at issue; whether the missing witness was available to testify; and whether or not the hearsay is corroborated.'" *Id.*, quoting *In the Matter of Mark James Hankoff*, 50 S.E.C. 1009, 1012 (1992). *See also see In the Matter of the Rockies Fund, et al.*, Exchange Act Rel. No. 26202 at 18, 2003 SEC LEXIS 2361 at *63-65 (Oct. 2, 2003), *vac. in part on other grounds*, 428 F.3d. 1088 (D.C. Cir. 2005), and *In the Matter of Marshall E. Melton, et al.*, Exchange Act Rel. No. 48228, Investment Advisers Act Rel. No. 2151 at n.15, 2003 SEC LEXIS 1767 at n.15 (July 25, 2003).

12 (May 8, 2002) (admitting expert testimony, citing *City of Anaheim*, but applying *Daubert/Kumho Tire* to restrict its weight); *In the Matter of Byron G. Borgardt*, Init. Dec. Rel. No. 167, 2000 SEC LEXIS 1141 at *11-*12 (June 1, 2000), *aff'd*, Securities Act Rel. No. 8274, Investment Company Act Rel. No. 26199, 2003 SEC LEXIS 2048 (Aug. 25, 2003); *In the Matter of Sky Scientific, Inc.*, Init. Dec. Rel. No. 137, 1999 SEC LEXIS 475 at *7 (March 5, 1999).

- i. Interestingly, when the issue is not relevance but the admission of prior testimony, the ALJs are sometimes less restrictive, and sometimes more restrictive, than the Federal Rules would require. *See In the Matter of Del Mar Financial Services, Inc.*, Securities Act Rel. No. 8314, Exchange Act Rel. No. 48691 at 9-10, 2003 SEC LEXIS 2538 at *30-*31 (Oct. 24, 2003); *In the Matter of Robert G. Weeks*, Init. Dec. Rel. No. 199 at 5-6, 2002 SEC LEXIS 268 at *12-15 (Feb. 4, 2002), *aff'd*, Securities Act Rel. No. 8313, Exchange Act Rel. No. 48684, 2003 SEC LEXIS 2572 (Oct. 23, 2003); *In the Matter of Robert Bruce Lohmann*, Admin. Proc. Rulings Rel. No. 598, 2002 SEC LEXIS 900 (April 11, 2002), *aff'd*, Exchange Act Rel. No. 48092, Investment Advisers Act Rel. No. 2141, 2003 SEC LEXIS 1521 (June 26, 2003).²⁰
- ii. At times ALJs can be as strict as any district judge in their application of evidentiary rules. *See In the Matter of Anthony C. Snell and Charles E. LeCroy*, Init. Dec. Rel. No. 330 at 45, 2007 SEC LEXIS 904 (May 3, 2007) (refusing to allow Division to rely on prior testimony shown to witness to refresh recollection, where Division counsel had neglected to ask the witness to state her refreshed recollection).
- c. Like district judges in criminal trials, the ALJs have a strong tendency to let the respondent “say his/her piece.” (As counsel, of course, you have to figure out whether letting your client do that is a good idea.) Unlike defendants in a criminal trial, respondents in A.P.s can be compelled to at least take the stand by the Division.
- d. ALJs also have a tendency, when the issue is raised, to force the Division to keep the alleged violations within the four corners of

²⁰ For an interesting discussion of how common-law testimonial privileges are treated in SEC administrative proceedings, *see In the Matter of Robert G. Weeks*, Init. Dec. Rel. No. 199 at 6-8, 2002 SEC LEXIS 268 at *16-24.

the Order Instituting Proceedings. Thus, although evidence outside the OIP may come in as background, you should be vigilant to make sure that your client's legal exposure stays within the bounds set by the OIP. *See, e.g., In the Matter of Gregory M. Dearlove, CPA*, Init. Dec. Rel. No. 315 at 45-46 n. 40, 49-51, 2006 SEC LEXIS 1684 (July 27, 2006); *In the Matter of Robert Bruce Lohmann*, Init. Dec. Rel. No. 214 at 13, 17 n.5, 2002 SEC LEXIS 2380 at *33, 46 n.5 (Sept. 19, 2002), *aff'd*, Exchange Act Rel. No. 48092, Investment Advisers Act Rel. No. 2141, 2003 SEC LEXIS 1521 (June 26, 2003); *In the Matter of Richmark Capital Corp.*, Init. Dec. Rel. No. 201 at 25, 2002 SEC LEXIS 601 at *67-69 (March 18, 2002), *aff'd*, Securities Act Rel. No. 8333, Exchange Act Rel. No. 48758, 2003 SEC LEXIS 2680 (Nov. 7, 2003); *but see In the Matter of Public Finance Consultants, Inc., et al.*, Init. Dec. Rel. No. 274 at 49-51, 2005 SEC LEXIS 433 at *128-*133 (Feb. 25, 2005) (holding objection to variant proof waived); *In the Matter of Byron G. Borgardt, et al.*, Securities Act Rel. No. 8274, Investment Co. Act Rel. No. 26169 at 6-8, 2003 SEC LEXIS 1521 at *16-*24 (Aug. 25, 2003) (upholding ALJ decision permitting Division to amend OIP after respondents objected to variance).²¹

- e. The ALJ also has power under Rule 111(d) to regulate the course of proceedings and the conduct of the parties, and can use that power to police the parties' conduct in calling last-minute, "surprise" witnesses. *See In the Matter of Gregory M. Dearlove, CPA*, at 60 & n.30, 2006 SEC LEXIS 1684.

2. Superficial Differences

- a. Don't be surprised to see Division counsel question witnesses and address the ALJ while seated at counsel table. You may either follow suit, or use the podium.
 - i. You will be strongly discouraged from "roaming" while arguing or questioning, because the reporting company uses tape decks to record the proceeding, and that system depends on your being near a microphone.
 - ii. ALJs like to see a fairly high degree of courtroom etiquette (*e.g.*, "May I approach the witness?")

²¹ The concept of amending the OIP at the Division's instance apparently does have limits, and does not extend to permitting the Division to substitute a wholly new respondent for the respondent whom the Commission originally named. *See In the Matter of E Trade Systems, Inc. (formerly known as Personal Portals Online, Inc.)*, Init. Dec. Rel. No. 301, 2005 SEC LEXIS 3137 (Nov. 29, 2005).

- b. A.P. “trial” hearings normally are held in the city where the SEC staff who originated the case are located. Unlike district court bench trials, SEC administrative hearings can move around the country if that is important for the witnesses (and, to a lesser extent, for the respondents). *See* Rule 200(c).²²
- c. The physical space in which the hearing takes place can vary dramatically, from a room in the basement of SEC HQ in Washington, to comparatively nicer quarters in the SEC’s regional and district offices, to positively ornate courtrooms that the SEC can arrange for in cities where there is no SEC office.

IV. Post Hearing Submissions

- A. The parties normally file proposed findings of fact and conclusions of law together with, or as part of, their briefs, as well as reply briefs (Rule 340(a)-(b)).
- B. The ALJ determines when these will be due; however, the overall time for transcript preparation and briefing will have been pre-set in the Order Instituting Proceedings at two months, subject to extension only if the new Rule 161(b) standards are met (see I(F) above).

V. How long do I wait for a decision after the hearing is over?

- A. Historically, parties have had to wait an average of 1-2 years for the Initial Decision, depending on the judge, but under the new scheduling rules the time allotted for preparation of an initial decision is to vary between one and four months, as specified in the Order Instituting Proceedings.

VI. What If My Client Is Aggrieved by the ALJ’s Initial Decision?

- A. Petition for Review by the Commission
 - 1. The filing of a petition for review automatically prevents the initial decision from becoming final (see Rule 360 (d)(1)).²³

²² In the comparatively rare case in which witness credibility plays no role, the hearing may be conducted by telephone. *See In the Matter of Stansbury Holdings Corp.*, Init. Dec. Rel. No. 232 at 2 & n.1, 2003 SEC LEXIS 1639 at *3-*4 & n.1 (July 14, 2003). Even more rarely, the hearing may be held outside the United States. *See In the Matter of Gordon Novak*, Init. Dec. Rel. No. 297, 2005 SEC LEXIS 2412 (Sept. 27, 2005).

²³ Rule 111(h) authorizes the ALJ to entertain and rule upon a motion to correct a manifest error of fact in the initial decision, provided that the motion to correct is filed within ten days of the initial decision” (*cf.* Fed. R. Civ. P. 59(e)). *See In the Matter of Raymond James Financial Services, Inc.*, Admin. Proc. Rul. Rel. No. 622, 2005 SEC LEXIS 3369 (Oct. 14, 2005); *In the Matter of Robert Cord Beatty*, Admin. Proc. Rul. Rel. No. 618, 2005 SEC LEXIS 359 (Feb. 10, 2005). According to Rule 410(b), a motion to correct tolls the time to file a petition for review until 21 days from the date of the

VII. Petitioning the Commission for Review

- A. When to file the petition -- Rule 360(b) says that “[t]he initial decision shall ... state the time period, not to exceed 21 days, after service of the decision, within which a petition for review of the initial decision may be filed.”
 - 1. Either the respondent or the Division of Enforcement, or both, may petition for review of an initial decision.
 - a. Rule 410(b) now permits a party to file a cross-petition for review within ten days from the filing of a petition by the other side, thus eliminating the Commission’s former “Gunfight at the O.K. Corral” approach and the need for a protective, defensive petition for review “just in case.”
 - 2. No matter what you and the Division decide to do, the Commission itself may decide to review an initial decision. *See* Rule 411(c).
 - a. On August 27, 2002, the Commission issued an order delegating to its General Counsel the authority, in every case, to raise the issue whether any sanction, and if so what sanction, should be imposed in the public interest. *See* Exchange Act Rel. No. 46418.
- B. What to put in the petition -- see Rule 410(b).
- C. Petitioning the Commission for review of the initial decision is a prerequisite for seeking judicial review in the courts of appeals. *See* Rule 410(e).

VIII. Proceedings on Review

- A. Rule 411 permits any party to move for “summary affirmance” within 21 days of the filing of a petition for review. Rule 411(e)(2) states the standard for summary affirmance. The Commission has held that summary affirmance is “rare.” *See In the Matter of Salvatore F. Sodano*, Exchange Act Rel. No. 56961 at 3, 2007 SEC LEXIS 2921 (Dec. 13, 2007). If a summary affirmance motion is pending, the Commission may delay issuance of a briefing schedule.

ALJ’s order resolving the motion. Although it remains to be seen whether there are any sanctions for such conduct (other than Rule 111(h)’s warning that a Rule 111(h) motion that purports to contest the substantive merits of an initial decision will be treated as a petition for review), ALJ Kelly has expressed sharp displeasure at a respondent whom he perceived to have made a Rule 111(h) motion as “a stalling tactic ... to afford [respondent] additional time to formulate the issues he intends to present to the Commission for review.” *See In the Matter of Gregory M. Dearlove, CPA*, Admin. Proc. Rul. Rel. No. 629, 2006 SEC LEXIS 1776 (Aug. 9, 2006).

- B. If the Commission grants review, it will set a briefing schedule (see Rule 450). These can be rather short; under Rule 450(a), the initial brief is due 30 days after the Commission issues its scheduling order.
- C. You or your adversary can seek oral argument by separate motion accompanying your initial brief, or the Commission can order oral argument *sua sponte* (Rule 451).

IX. Arguments before the Commission.

- A. These somewhat resemble appellate arguments in the sense that you don't re-try your case, but argue for reversal or affirmance based on the law and "the record". See Rule 460.
 - 1. Because the Commission's review is "de novo," the Commission can re-find the facts that were in the record before the ALJ.
 - 2. If you want additional material to go into the record after the case has gone to the Commission, you must make a motion under Rule 452, but this path is not always easy. See *In the Matter of Impax Laboratories, Inc.*, Exchange Act Rel. No. 57864 at nn. 17, 27, 2008 SEC LEXIS 1197 at nn. 17, 27 (May 23, 2008); *In the Matter of John J. Kenny, et al.*, Securities Act Rel. No. 8234, Exchange Act Rel. No. 47847, Investment Advisers Act Rel. No. 2128 at n.55, 2003 SEC LEXIS 1170 at n.55 (May 14, 2003).
 - 3. Rule 451(b) now prohibits the use of visual aids at oral argument unless copies have been provided to the Commission and to all parties at least five business days before the argument is held.

X. How long do I wait for a decision from the Commission?

- A. Although it has been careful not to put itself under any enforceable time limit, the Commission now gives itself seven months under Rule 900 to decide petitions for review. New Rule 900(a)(1)(iii) requires the Commissioners to make findings if this self-imposed time limit is to be exceeded. If decision of a petition for review is to take more than seven, but less than eleven, months, the Commission apparently must find that "unusual complicating circumstances" exist. If the case is to remain pending for more than eleven months, the Commission must determine that "extraordinary facts and circumstances of the matter so require."

XI. Reconsideration

- A. Rule 470 permits motions for reconsideration of Commission decisions. However, the Commission has held that reconsideration is limited to "exceptional" cases, is intended for the correction of manifest errors of law or fact or the presentation of newly-discovered evidence, and may not be used to reiterate argument previously made or to cite authorities previously available. See *In the*

Matter of the Rockies Fund, Inc., Exchange Act Rel. No. 49788 at 3, 2004 SEC LEXIS 1114 at *3-*4 (June 1, 2004), *vac. in part on other grounds*, 428 F.3d 1088 (D.C. Cir. 2005).

XII. Appeal from an Adverse Commission Decision

- A. Within sixty days after the entry of the Commission's order in the case, an aggrieved respondent may file a petition for review of the Commission's decision with the federal court of appeals where he/she resides or has his/her principal place of business, or with the D.C. Circuit (*see* Section 25(a)(1) of the Exchange Act, 15 U.S.C. § 78y(a)(1)).
1. From this point forward, procedure is governed by the Federal Rules of Appellate Procedure and the court of appeals' own rules.
 2. The standard of review is quite deferential to the agency -- *see id.*; 5 U.S.C. § 706(2). However, the SEC does not win them all. *See Rockies Fund, Inc. v. SEC*, 428 F.3d 1088 (D.C. Cir. 2005); *Monetta Financial Services, Inc. v. SEC*, 390 F.3d 952 (7th Cir. 2004); *Wallace v. SEC*, 2004 U.S. App. LEXIS 18418 (D.C. Cir. Aug. 30, 2004); *Howard v. SEC*, 376 F.3d 1136 (D.C. Cir. 2004); *Marrie v. SEC*, 374 F.3d 1196 (D.C. Cir. 2004); *WHX Corp. v. SEC*, 362 F.3d 854 (D.C. Cir. 2004); *Koch v. SEC*, 177 F.3d 784 (9th Cir. 1999); *Checkosky v. SEC*, 139 F.3d 221 (D.C. Cir. 1998); *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996); *Upton v. SEC*, 75 F.3d 92 (2d Cir. 1996).