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PANEL II: SEC Enforcement: New Directions Under Chairman Clayton

Moderator: **Tom Gorman**, Partner, Dorsey & Whitney; former official in the Enforcement Division, SEC

Special guest speakers:

Stephen W. Hall, Legal Director and Securities Specialist, Better Markets
Susan Markel, Managing Director, AlixPartners; former Chief Accountant in the Enforcement Division, SEC
Brian P. O'Shea, Senior Director at the Center for Capital Market Competitiveness, Chamber of Commerce
Martin Wilczynski, Senior Managing Director, Ankura; former official in the Enforcement Division, SEC
Anat Carmy-Wiechman, Associate Director of the NYU Pollack Center for Law and Business

SEC ENFORCEMENT
NEW DIRECTIONS UNDER CLAYTON

DORSEY'S FOURTH ANNUAL FEDERAL ENFORCEMENT FORUM

December 6, 2017

INTRODUCTION

- **Jay Clayton became the Chairman of the SEC on May 4, 2017**
- **To date the Senate has not confirmed the Administration's other nominees to the agency**
- **Nevertheless, the Chairman has revamped the senior staff of the agency**
- **Enforcement is now directed by co-directors Stephanie Avakian and Steven Peikin**

INTRODUCTION

- **Recently, the Commission announced a new direction and focus for the Division of Enforcement**
- **This program will**
  - **Take a brief look back at where the Division has been**
  - **Examine the announced new direction**
  - **Explore the challenges the Division faces**

A BRIEF LOOK BACK

- **In recent years the Commission and the Commission and/or Division has been lead by former federal prosecutors**
- **Enforcement adopted a "broken windows" approach from the NYPD – all cases all the time**
- **Increasing numbers of cases were brought each year**

A BRIEF LOOK BACK

- For example, according to the SEC, in fiscal 2016
  - A record 548 standalone cases were brought
  - 160 actions were against investment advisers or investment companies, another record
  - Many were brought against microcap issuers and manipulators
  - Another key focus was gatekeepers

THE NEW APPROACH

- The new approach focuses on 5 principles:
  - ➢ Main Street Investors
    - The Retail Strategy Task Force was formed
  - ➢ Individual accountability
  - ➢ Keep pace with technology
    - The Cyber Unit was formed
  - ➢ Impose effective sanctions
  - ➢ Constant assessment of resources

THE NEW APPROACH

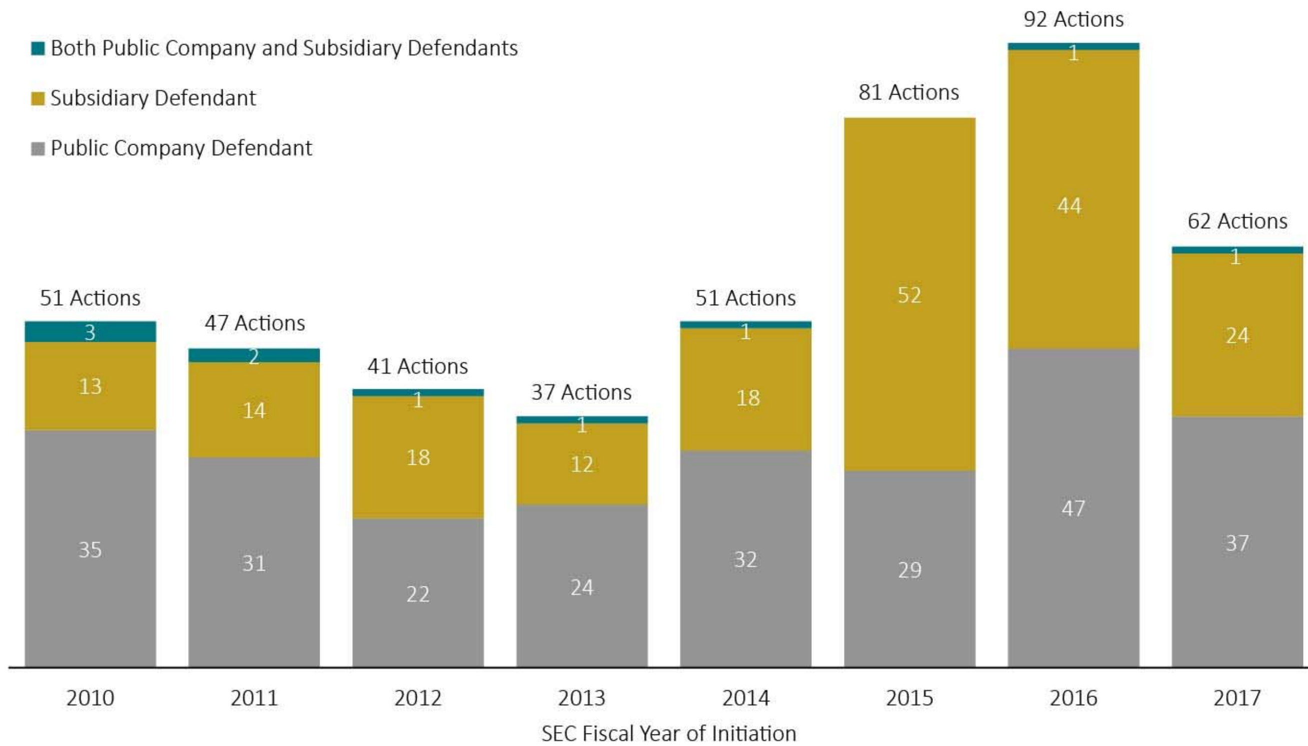
- Is the new approach different or just narrower?
- While it is very early to assess the work of the current Commission, statistics on the work of the Division complied by Cornerstone Research and NYU present certain issues
  - Note: the following statistics and charts were developed by and taken from Cornerstone Research and NYU related to public companies and their subsidiaries only – they are not based on all enforcement actions

THE NEW APPROACH

- Chart 1: SEC Actions against public companies and their subsidiaries, 2010 – 2017
- The statistics show a significant drop from fiscal 2016 to 2017

Public Company–Related SEC Actions

FY 2010–FY 2017



Source: Securities Enforcement Empirical Database (SEED)
Note: Relief defendants are not considered.

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THE NEW APPROACH

- Chart 2: Types of Allegations re public companies and their subsidiaries
- Shows the mix of cases is roughly the same, with the biggest difference in issuer reporting/disclosure
- The statistics in the the call out box for 2016 – 2017 are for the top 3 categories of cases
- Essentially the categories appear the same, although there is an increase of 13% for the issuer reporting disclosure category over the last two fiscal years

Heat Map of Allegations against Public Company–Related Defendants

FY 2010–FY 2017

Allegation Type	SEC [illegible]								
	Average 2010–2016	2010	2011	20[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Issuer Reporting and Disclosure	36%	43%	32%	2[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Investment Advisor/ Investment Companies	10%	6%	4%	1[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Foreign Corrupt Practices Act	20%	24%	36%	2[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Broker Dealer	10%	10%	13%	1[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Securities Offering	7%	6%	4%	7%	19%	4%	1%	9%	5%
Municipal Securities/ Public Pensions	11%	4%	11%	10%	0%	4%	40%	9%	0%
Market Manipulation	2%	0%	0%	5%	5%	2%	0%	0%	0%
Other	3%	8%	0%	2%	0%	4%	5%	4%	6%
Number of Actions	57	51	47	41	37	51	81	92	62

Allegation Type	2016	2017
Issuer Reporting and Disclosure	26%	39%
Investment Advisor/ Investment Companies	21%	21%
Foreign Corrupt Practices Act	20%	16%

Legend: 0% | 1–10% | 11–20% | 21–50% | 51–100%

Source: Securities Enforcement Empirical Database (SEED)
Note: Relief defendants are not considered. Percentages may not add to 100 percent due to rounding. “Other” includes actions categorized by the SEC as “Other” or “Transfer Agent.”

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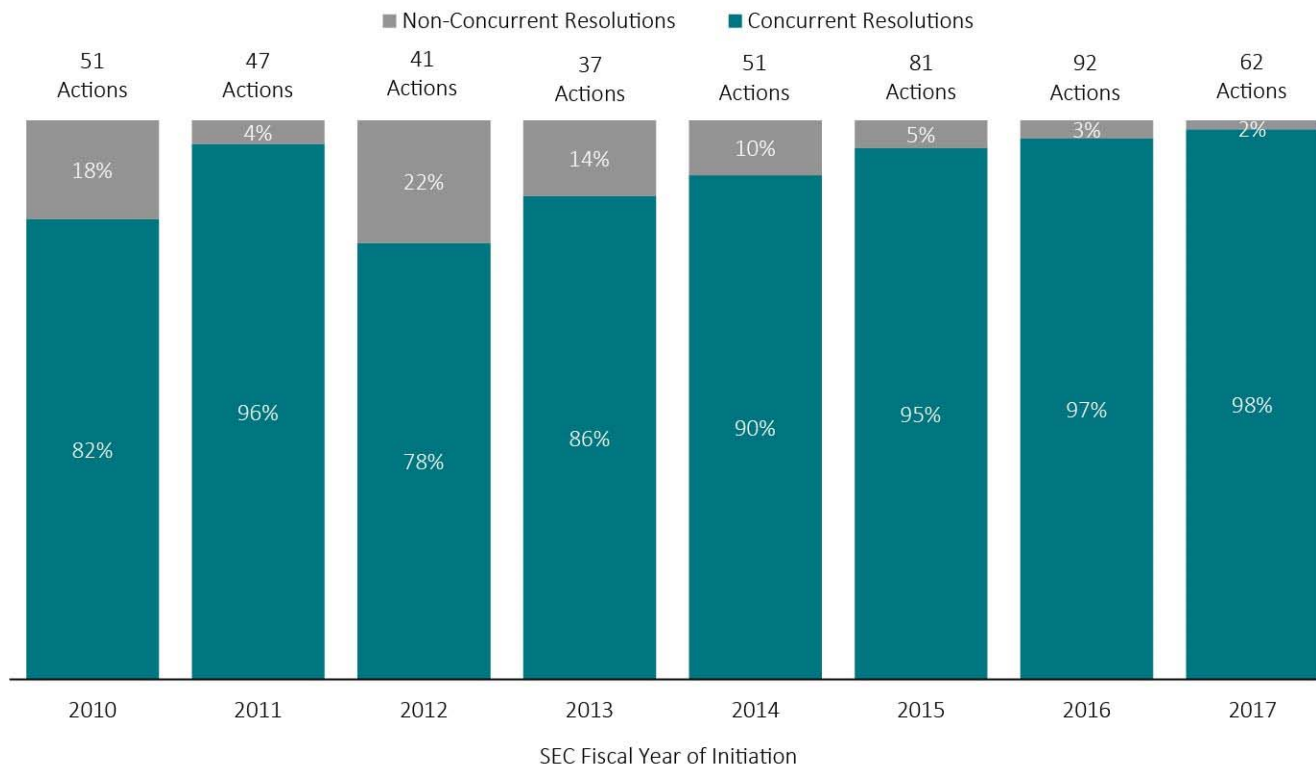
THE NEW APPROACH

- Chart 3: Timing of Resolutions
- Traditionally most public companies and their subsidiaries resolve enforcement investigations at the time they are filed
- That trend seemed to continue in fiscal 2017



Source: Securities Enforcement Empirical Database (SEED)
Note: Relief defendants are not considered. Actions that are initiated and resolved on the same day are concurrent resolutions.

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THE NEW APPROACH

- Time of settlement: While most issuers and their subsidiaries settle at the time of filing, the timing of settlement can impact the penalty
- Cornerstone – NYU found that:
  - For FY 2017 89% of settling issuers and their subsidiaries paid a penalty; this was comparable to FY 2016 and FY 2015
  - Between the first half of FY 2017 and the second the percentage of issuer settlements with a monetary penalty dropped from 94% to 78% (p. 9)

THE NEW APPROACH

- In considering concurrent and non-concurrent settlements, and the question of a monetary component over time, the Cornerstone – NYU Report also notes:

  " Actions with non-concurrent resolution were less likely to have monetary settlements from FY 2010 through FY 2017, 71% of actions with non-concurrent resolutions had monetary settlements, compared to 88% of actions with concurrent resolutions" according to Cornerstone – NYU at 10

THE NEW APPROACH

- Chart 4: Cooperation
- Cooperation, long deemed critical to SEC enforcement along with whistleblowers, appears to have declined for actions involving public companies and their subsidiaries
- This is particularly true in the second half of fiscal 2017

Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. Actions resolved through trial are excluded. An action with cooperation indicates a defendant's cooperation with the SEC prior to the non-trial resolution of that action. The words "cooperation" or "remediation" must be mentioned in the document detailing the non-trial resolution, or the SEC must acknowledge voluntary reporting by the defendant. Settlements are counted at the defendant level.

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ISSUES FACING THE DIVISION

- **Significant issues facing the Commission and Enforcement going forward**
  - **Remedies**
  - **Cooperation**
  - **Whistleblower Protection**
  - **ALJs**
  - **Insider Trading**
  - **Financial Fraud**

ISSUES FACING THE DIVISION

Remedies

- One of the key principles of the new enforcement program is to “impose sanctions that most effectively further enforcement goals”
- A long used remedy in enforcement actions is disgorgement

ISSUES FACING THE DIVISION

Remedies

- Yet in *Kokesh v. SEC,* 137 S.Ct. 1635, n. 3 (2017) the Court stated:

  > " Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context."

- What approach should the Commission take to this issue?

ISSUES FACING THE DIVISION

Cooperation

- In marshaling its scarce resources – a key principle in the new enforcement approach – cooperation has long been considered critical, tracing to the FCPA Volunteer Program of the 1970s
- Yet, at least issuer cooperation appears to be declining
- Does the Commission need to revamp its approach ?

ISSUES FACING THE DIVISION

Cooperation

- Should the Commission consider adopting more special cooperation programs, such as:
  - Municipalities Continuing Disclosure Cooperation Initiative: a voluntary self-reporting program that targeted material misstatements and omissions in bond offering documents, which concluded in FY 2016 and accounted for 15% (84) of the actions brought that year.
  - FCPA Corporate Enforcement Policy: last week the DOJ announced a permanent adoption of its FCPA Pilot Program to encourage cooperation, offering declinations in certain instances. During the 18 months it was in effect, the DOJ received 30 voluntary disclosures from companies, compared to 18 in the preceding 18-month period.

ISSUES FACING THE DIVISION

Whistleblower Protection

- **In recent years the Commission has come to rely on its whistleblower program as a source of information**
  - **Does the Supreme Court's looming decision in *Digital Realty Trust, Inc., v. Somers,* No. 16-1276 jeopardize this approach?**

ISSUES FACING THE DIVISION

Whistleblower Protection

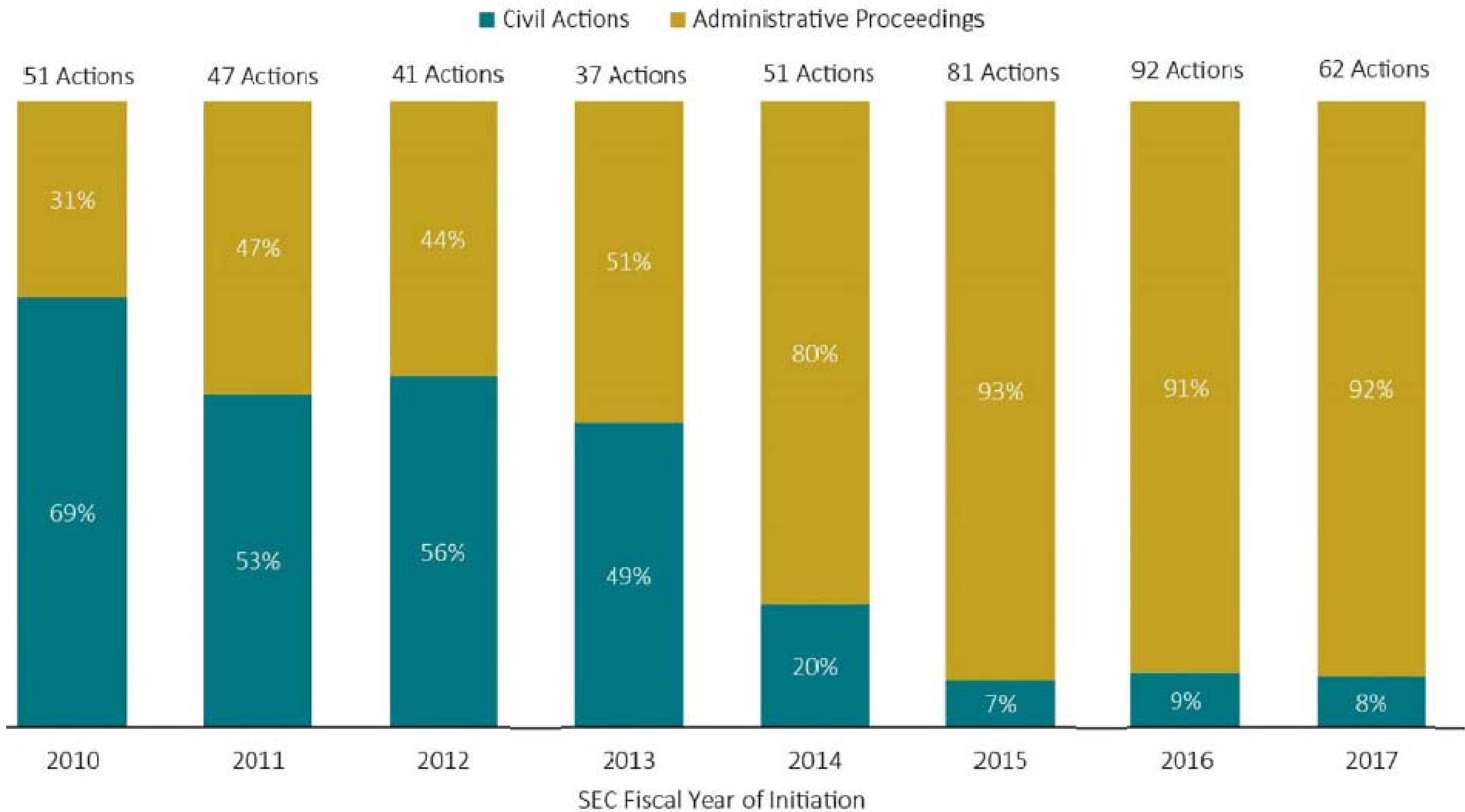
- **In *Digital Realty Trust, Inc., v. Somers* the Court is considering whether whistleblowers must first report to the SEC to receive anti-retaliation protection or whether they can also report to the issuer**
  - **At stake, in part, are rules written by the SEC which would require a report to the agency to obtain those protections under Dodd-Frank but not SOX**

ISSUES FACING THE DIVISION

ALJs

- **Recently the SEC has brought more if its enforcement actions as administrative proceedings**
- **This trend is reflected in the following chart**

Public Company and Related Subsidiary Actions by Enforcement Venue
FY 2010–FY 2017



urce: Securities Enforcement Empirical Database (SEED)
te: Relief defendants are not considered.
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ISSUES FACING THE DIVISION

ALJs

- **This resulted in a number of suits attempting to block this trend**
- **A the center of those cases is the question of whether SEC ALJs were properly appointed under the Constitution's Appointments Clause**
- **A key case in this regard, pending cert before the Supreme Court, *Raymond J. Lucia Companies v. SEC,* No. 15-1345.**

ISSUES FACING THE DIVISION

ALJs

- **To address this issue, last week the Commission entered an order which formally appointed each of its ALJs in accord with the Constitution. *In re Pending Administrative Proceedings*, Securities Act of 1933, Release No. 10440 (Nov. 30, 2017)**
- **In addition, the order directed ALJs to reconsider pending cases after permitting respondents to supplement the record**

ISSUES FACING THE DIVISION

ALJs

- **In *Raymond J. Lucia* the government filed a reply brief urging that the Court hear the case, noting that the SEC has conformed its appointment process to the constitution and urging that an amicus be appointed to defend the lower court ruling**

ISSUES FACING THE DIVISION

ALJs

- **Do the steps taken by the Commission fully address the errors caused by failing to properly appoint its ALJs?**
- **Consider the Commission's position on the constitutional issue according to the DC Circuit:**
- **".. . the government does not maintain that the Commission's decision can be upheld if the presiding ALJ was unconstitutionally appointed . . .The Commission has acknowledged the ALJ was not appointed as the Clause requires, and the government does not argue harmless error would apply."**

***Raymond J. Lucia Companies, Inc. v. SEC,* 623 F. 3d 277, 283 (D.C. Cir. 2016)**

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ISSUES FACING THE DIVISION

Insider Trading

- **This has long been a staple of SEC Enforcement; while not specifically mentioned as an area of focus, presumably the SEC will continue to bring cases here**
- **Recent court decisions, however, raise questions about what constitutes the elements of illegal tipping In *Salman v. U.S.* 137 S. Ct. 420 (2016) the court reaffirmed its decision in *Dirks v. SEC,* 463 U.S. 646 (1983) regarding the personal benefit test**
- **In *U.S. v Martoma,* Docket No. 14-3599 (2d Cir. Aug. 23, 2017) a split panel of the Second Circuit adopted an expansive ruling of *Salaman* and effectively overruled the decision of an earlier panel in *U.S. v. Newman,* 73 F. 3d 438 (2d Cir. 2014) on whether evidence of a close personal relationship was required in tipping cases involving friends and family**
- **Is it time to write legislation prohibiting insider trading?**

ISSUES FACING THE DIVISION

Financial Fraud

- Financial fraud has also long been a staple of SEC enforcement, although it has not been referenced by the current administration as a priority
- Previously a task force on financial fraud was created and efforts were made to use IA as an assist
- Are these efforts continuing?
- Also Audit Analytics recently published a report that shows the number of restatements is declining while the number of revisions – corrections without a restatement – are increasing
- In view of the decline in issuer cooperation does this suggest that perhaps issuers are circumventing restatements to avoid SEC scrutiny?
- Would a new cooperation approach have an impact here?

CONCLUSION

- SEC Enforcement has charted a new course under Chairman Clayton
- It has announced priorities centered on retail investors and cyber
- While it is to early to assess the success of this approach, there is little doubt that SEC Enforcement faces a series of difficult challenges which may ultimately determine the success of the program

U.S. SECURITIES AND EXCHANGE COMMISSION

Division of Enforcement

ANNUAL REPORT
A LOOK BACK AT FISCAL YEAR 2017

Disclaimer
This is a report of the staff of the U.S. Securities and Exchange Commission. The Commission has expressed no view regarding the analysis, findings, or conclusions contained herein.

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Report available on the Web at www.sec.gov/reports

MESSAGE FROM THE CO-DIRECTORS

Stephanie Avakian
CO-DIRECTOR

Steven Peikin
CO-DIRECTOR

Chairman Jay Clayton appointed us as Co-Directors of the U.S. Securities and Exchange Commission's Division of Enforcement in June 2017. We approach our roles guided by one overarching principle: Vigorous enforcement of the federal securities laws is critical to combat wrongdoing, compensate harmed investors, and maintain confidence in the integrity and fairness of our markets.

We bring to this task our combined experiences in the U.S. Attorney's Office in Manhattan, the Commission's Enforcement Division, and private law firm practice. With that background, we asked ourselves at the outset: What goals should we pursue? The question almost answers itself: protect investors, deter misconduct, and punish wrongdoers. But how to achieve those objectives is the real question. While we necessarily police a broad landscape and have numerous areas of focus, at a high level, our decision making is guided by five core principles.

Principle 1: Focus on the Main Street Investor.
Chairman Clayton has said that the Commission's analysis of whether it is accomplishing its mission "starts and ends with the long-term interests of the Main Street investor." We agree. Retail investors are often not only the most prevalent participants in our marketplace, but also the most vulnerable and least able to weather financial loss. We will continue to address the kinds of misconduct that traditionally have affected retail investors: accounting fraud, sales of unsuitable products and the pursuit of unsuitable trading strategies, pump and dump frauds, and Ponzi schemes, to name just a few.

We recently announced the formation of a Retail Strategy Task Force to develop effective strategies to address harm to retail investors. The task force will work closely with the Commission's examination staff, as well as the Office of Investor Education and Advocacy, and use data analytics to identify areas of risk to retail investors.

As we enhance our focus on retail investors, we will continue to vigorously pursue cases against financial institutions and intermediaries. We do not face a binary choice between protecting Main Street and policing Wall Street. The Commission has recently brought cases against Wall Street firms for a wide variety of misconduct, including: failing to ensure that retail clients understood the risks of complex financial products; overcharging millions in advisory fees; and putting investors in high-fee mutual fund share classes, when identical, lower-cost shares were available. Simply stated, our oversight of Wall Street is most effective, and protects those who need it most, when viewed through a lens focused on retail investors.

Principle 2: Focus On Individual Accountability.

The Commission has long pursued misconduct by both institutions and individuals. And it will continue to do so. But common sense and experience teach that individual accountability more effectively deters wrongdoing. The vigorous pursuit of individual wrongdoers must be the key feature of any effective enforcement program. That pursuit will send strong messages of both general and specific deterrence and strip wrongdoers of their ill-gotten gains. In many instances, we must also seek to protect investors by barring serious wrongdoers and recidivists from our markets.

In the six months since Chairman Clayton took office, pursuing individuals has continued to be the rule, not the exception. One or more individuals have been charged in more than 80 percent of the standalone enforcement actions the Commission has brought. To be sure, this focus on individuals consumes more of our limited resources; with more to lose, individuals are more likely to litigate with the Commission. But that price is worth paying.

Principle 3: Keep Pace With Technological Change.

Technology has dramatically transformed our markets. So too has it transformed the ability of wrongdoers to engage in cyber-enabled misconduct. Just a few years ago, it was difficult to imagine a market manipulation scheme accomplished by hacking into the electronic accounts of others and then forcing trades to pump up a stock price. Or the brokering of stolen inside information on the so-called "dark web," paid for in untraceable cryptocurrency. Yet these are the sort of schemes we now frequently encounter.

As nefarious actors take advantage of technological change and market evolution, the Commission's enforcement efforts must respond with purpose and vigor. To that end, we formed a specialized Cyber Unit to consolidate our substantial cyber-related expertise. The Cyber Unit includes experts in cyber intrusions, distributed ledger technology, and the dark web. Its members investigate and prosecute these increasing technologically-driven violations and coordinate with the Department of Justice and other criminal authorities.

Principle 4: Impose Sanctions That Most Effectively Further Enforcement Goals.

Sanctions are critical to driving behavior, and we have a wide array of tools available to further our objectives. Our remedies include: obtaining monetary relief in the form of disgorgement, penalties, and asset freezes; barring wrongdoers from working in the securities industry; and, when appropriate, obtaining more tailored relief, such as specific undertakings, admissions of wrongdoing, and monitoring or other compliance requirements. We do not believe in a formulaic or statistics-oriented approach. Instead, in every case we will consider the package of remedies that will be most appropriate in the matter at hand and more broadly.

Principle 5: Constantly Assess The Allocation Of Our Resources.

The volume of potential securities violations reflects the multi-trillion-dollar size of our markets. Last year alone, Commission personnel reviewed more than 16,000 tips, largely from the general public, and more than 20,000 reports of suspicious activity filed by broker-dealers and other entities.

The Enforcement Division is the Commission's largest division, but employs fewer than 1,200 professionals. As a result, we must constantly assess whether we are allocating our resources to address the most significant market risks and in the most effective manner, keeping front of mind the violators who pose the most serious threats to investors and market integrity.

Evaluating Our Efforts.

Judging the effectiveness of our resource allocation is a complex task. Traditionally, many have judged the Commission on quantitative metrics. Measured by those standards, Fiscal Year (FY) 2017 was successful. The Commission brought 754 actions and obtained judgments and orders totaling more than $3.7 billion in disgorgement and penalties. Significantly, it also returned a record $1.07 billion to harmed investors, suspended trading in the securities of 309 companies, and barred or suspended more than 625 individuals.

While such statistics provide some kind of measurement, they provide a limited picture of the quality, nature, and effectiveness of our efforts. For example, returning $100,000 to several dozen defrauded investors has little impact on our overall statistics, but can be life-changing for those investors. And, of course, violations that are prevented or deterred are never reflected in statistics. We also note that some cases take many years from initiation to resolution. Note that in 2017, $1.07 billion was distributed to harmed investors while $140 million was distributed in 2016, but much of the effort that resulted in the 2017 numbers occurred in prior years.

As a result, we believe the Commission's enforcement program should be judged both quantitatively and qualitatively and over various time periods. Have we focused on the most serious violations? Have we obtained meaningful punishments that deter unlawful conduct? Have we incapacitated wrongdoers? Are we recouping ill-gotten gains and returning money to investors? We believe the course we have set, and the principles we are following, answer all those questions in the affirmative.

This report is part of our effort to measure our effectiveness and our progress toward achieving these five objectives. In this report, we discuss the Enforcement Division's activity over the past fiscal year—activity that we believe should be assessed not just quantitatively, but also qualitatively.

Sincerely,

Stephanie Avakian and Steven Peikin
Co-Directors, Division of Enforcement
U.S. Securities and Exchange Commission
November 15, 2017

INTRODUCTION

The ongoing efforts made by the Division of Enforcement (Enforcement) to deter misconduct and punish securities law violators are critical to safeguarding millions of investors and instilling confidence in the integrity of the U.S. markets. Each year, Enforcement brings hundreds of civil enforcement actions against individuals and entities for fraud and other misconduct. The substantial remedies we obtain are important. They protect investors by deterring future wrongdoing, and when we obtain disgorgement of ill-gotten gains, harmed investors are often compensated. We also seek bars that prevent wrongdoers from working in the securities industry, as we believe holding individuals accountable for their improper actions is important and effective. It is a privilege to work in the securities industry and it is no place for bad actors.

INITIATIVES

Enforcement has a broad mandate with responsibility for covering broad ground across the securities markets. But, at the most basic level, the Division's area of greatest focus—protection of retail investors—has not changed over time. Today, this perspective is driving our resources to: risks posed by cyber-related misconduct; issues raised by the activities of investment advisers, broker-dealers, and other registrants; financial reporting and disclosure issues involving public companies; and insider trading and market abuse. These issues will be priorities for the Division, and we will continue to pursue cases and advance efforts to protect retail investors and market integrity.

In an effort to more closely align our allocation of resources with two of our key priorities—specifically, protecting retail investors and combatting cyber-related threats—at the end of FY 2017, the Division announced the creation of a Cyber Unit and a Retail Strategy Task Force.

The Cyber Unit

To combat cyber-related threats, which are among the greatest risks facing our securities markets, the Division formed a Cyber Unit. The Cyber Unit combines Enforcement's substantial, existing cyber-related expertise and its proficiency in digital ledger technology. The Unit initially will focus its efforts on the following key areas:

- Market manipulation schemes involving false information spread through electronic and social media;
- Hacking to obtain material nonpublic information and trading on that information;
- Violations involving distributed ledger technology and initial coin offerings (ICOs);
- Misconduct perpetrated using the dark web;
- Intrusions into retail brokerage accounts; and
- Cyber-related threats to trading platforms and other critical market infrastructure.

Although Enforcement has been focused on many of these issues for some time, the Cyber Unit formalizes the Division's efforts to develop and apply the Commission's considerable expertise in this rapidly-developing area.

While the end result of the Division's work is often a recommendation that the Commission take enforcement action, we also pursue alternatives where appropriate. The Division's recent activity in cyber-related actions provides two examples. First, in recognition of the growing use of distributed ledger technology and ICOs, in July 2017, the Commission released a Report of Investigation that concluded that the federal securities laws may apply to certain initial coin offerings or other distributed ledger or blockchain-enabled means for raising capital, depending on the facts and circumstance.[1] Second, in early November 2017, Enforcement and the Commission's Office of Compliance Inspections and Examinations (OCIE) issued a public statement concerning endorsements of stocks and other investments by celebrities and others on social media networks.[2]

The Retail Strategy Task Force

Effective enforcement of the federal securities laws is critical to safeguarding the long-term interests of retail investors. To focus the Division on the type of misconduct that often targets retail investors, the Division formed the Retail Strategy Task Force. The Task Force will be dedicated to developing effective strategies and methods to identify potential harm to retail investors. The Task Force builds on the Division's past efforts to protect retail investors and will draw from the Division's deep experience in the area. It is focused, in particular, on harnessing the Commission's ability to use technology and data analytics to identify large-scale wrongdoing. The Task Force also works closely with OCIE to identify areas of risk to retail investors, and with the Commission's Office of Investor Education and Advocacy to educate retail investors about those risks.

The Task Force will focus on wrongdoing implicating the microcap market, as well as Ponzi schemes and offering frauds, where victims typically are retail investors. But the Task Force also will focus on identifying misconduct in other areas, such as that which occurs at the intersection of investment professionals and retail investors, which can present significant opportunity for misconduct. Some examples of this type of misconduct include steering clients to higher-cost mutual fund share classes, abuses in wrap-fee accounts, investment adviser recommendations to buy and hold highly volatile products like inverse exchange-traded funds, suitability issues involving the sale of structured products to retail investors, and abusive sales practices such as churning and excessive trading.

1 www.sec.gov/litigation/investreport/34-81207.pdf.

2 www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos.

DISCUSSION AND ANALYSIS OF FISCAL YEAR 2017

Overall Results

Even in the midst of transition in leadership, FY 2017 was a successful and impactful year for the Enforcement Division. The Commission brought a diverse mix of 754 enforcement actions, of which:

- 446 were "standalone" actions brought in federal court or as administrative proceedings;
- 196 were "follow-on" proceedings seeking bars based on the outcome of Commission actions or actions by criminal authorities or other regulators; and
- 112 were proceedings to deregister public companies—typically microcap—that were delinquent in their Commission filings.

Detailed results from FY 2017 are set forth below. FY 2016 results are also reflected below for comparison.

The number of standalone enforcement actions decreased in FY 2017 when compared to FY 2016. The bulk of that difference is attributable to 84 actions brought in FY 2016 (roughly 15 percent of standalone actions that year) as part of the Commission's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, a voluntary self-reporting program that targeted material misstatements and omissions in municipal bond offering documents. The MCDC Initiative concluded in FY 2016.

Enforcement Actions Filed in Fiscal Year 2017 and 2016 (Including MCDC)

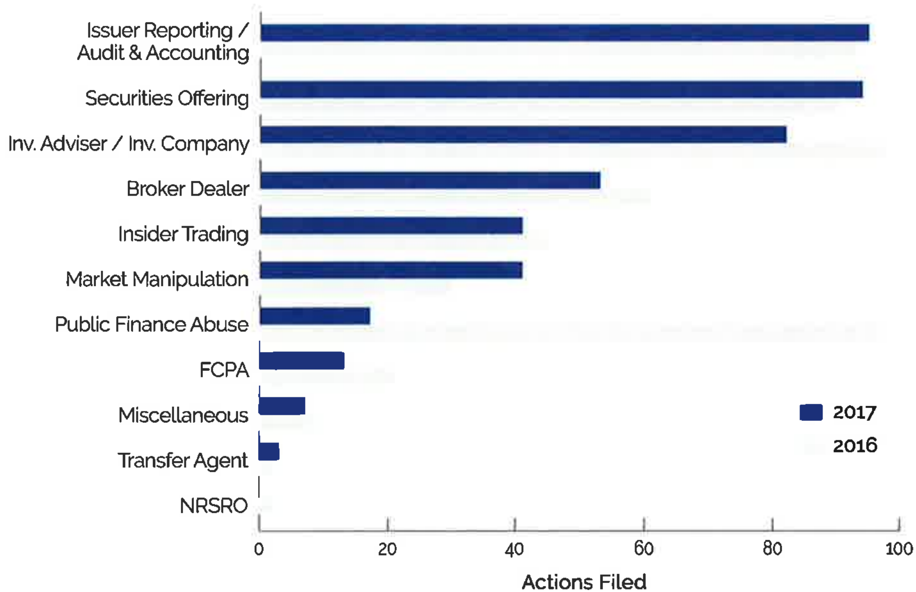
	FY 2017	FY 2016
Standalone Enforcement Actions	446	548
Follow-on Admin. Proceedings	196	195
Delinquent Filings	112	125
Total Actions	**754**	**868**

Enforcement Actions Filed in Fiscal Year 2017 and 2016 (Excluding MCDC)

	FY 2017	FY 2016
Standalone Enforcement Actions	446	464
Follow-on Admin. Proceedings	196	195
Delinquent Filings	112	125
Total Actions	**754**	**784**

Types of Cases

As the chart below illustrates, consistent with FY 2016, a significant number of the Commission's 446 standalone cases in FY 2017 concerned investment advisory issues, securities offerings, and issuer reporting/accounting and auditing, each comprising approximately 20 percent of the overall number of standalone actions. The Commission also continued to bring actions relating to market manipulation, insider trading, and broker-dealers, with each comprising approximately 10 percent of the overall number of standalone actions, as well as other areas.



A breakdown of the number and percentage of the types of actions brought in FY 2016 and 2017 is in the attached appendix.

Disgorgement and Penalties Ordered

In FY 2017, the Commission continued to obtain significant monetary judgments against parties in enforcement actions. All told, parties in the Commission's actions and proceedings were ordered to pay a total of $2.9 billion in disgorgement of ill-gotten gains, an increase over the prior year. Penalties imposed totaled $832 million, a decrease from the prior year. Total monetary relief ordered in FY 2017 declined approximately seven percent from the prior year.

Total Money Ordered (in millions)		
	FY 2017	FY 2016
Penalties	$832	$1,273
Disgorgement	$2,957	$2,809
Total	**$3,789**	**$4,083**

As the below tables demonstrate, the five percent of cases that involve the largest penalties and disgorgement account for the vast majority of all financial remedies the Commission obtains. Yet the remaining 95 percent of cases not only constitute the bulk of the Enforcement Division's overall activity, but also address the broadest array of conduct. This is one illustration of how statistical assessments present an incomplete picture.

Penalties Ordered (in Millions)				
	2017		2016	
	Total	Pct	Total	Pct
Top 5% Largest Cases	$514	62%	$954	75%
Remaining 95% Cases	$318	38%	$320	25%
Total	**$832**	**100%**	**$1,274**	**100%**

Disgorgement Ordered (in Millions)				
	2017		2016	
	Total	Pct	Total	Pct
Top 5% Largest Cases	$2,046	69%	$1,848	66%
Remaining 95% Cases	$911	31%	$961	34%
Total	**$2,957**	**100%**	**$2,809**	**100%**

Experience has shown that in most years, a significant percentage of the disgorgement and penalty totals are attributed to a small number of cases. As illustrated below, this was the case in FY 2016 and 2017.

Disgorgement Orders Over $100 Million in Fiscal Year 2017	
Party	Amount
Telia Company AB	$457 million
Braskem S.A.	$325 million
Teva Pharm. Industries Ltd.	$236 million
Steve Chen, et al.	$145 million
JPMorgan Chase & Co.	$131 million
Total Disgorgement Orders Over $100 M	**$1.294 billion**
Percentage of Total Disgorgement Ordered in FY 2017	**44%**

Disgorgement Orders Over $100 Million in Fiscal Year 2016	
Party	Amount
JPMorgan Chase Bank, N.A., et al.	$139 million
Trevor G. Cook, et al.	$264 million
Louis V. Schooler	$148 million
VimpelCom Ltd.	$375 million
The Bank of New York Mellon	$133 million
Och-Ziff Capital Mgmt Group LLC, et al.	$201 million
Total Disgorgement Orders Over $100 M	**$1.260 billion**
Percentage of Total Disgorgement Ordered in FY 2016	**45%**

Penalty Orders Over $50 Million in Fiscal Year 2017	
Party	**Amount**
Credit Suisse AG	$90 million
State Street Bank & Trust Co.	$75 million
Ming Xu	$57 million
Total Penalty Orders Over $50 Million	**$222 million**
Percentage of Total Penalties Ordered in FY 2017	**27%**

Penalty Orders Over $50 Million in Fiscal Year 2016	
Party	**Amount**
Merrill Lynch	$358 million
Weatherford Int'l	$140 million
JPMorgan Chase Bank, N.A., et al.	$128 million
Monsanto Company	$ 80 million
Total Penalty Orders Over $50 Million	**$706 million**
Percentage of Total Penalties Ordered in FY 2016	**55%**

More information about the actions that led to these disgorgement and penalty orders is available in the appendix.

Finally, a substantial amount of money was returned to harmed investors in FY 2017. In the past two years combined, the Commission distributed $1.21 billion to victims of wrongdoing. The majority of funds were distributed in FY 2017, when the Commission returned a record $1.07 billion to harmed investors.

Money Distributed to Harmed Investors (in millions)	
FY 2017	FY 2016
$1,073	$140

A significant portion of the total funds distributed in FY 2017 ($814 million) came from four Fair Funds—a $494 million disbursement from the CR Intrinsic Investors fund,[3] a $200 million disbursement from a JPMorgan Chase fund,[4] and a $120 million disbursement from two related Credit Suisse RMBS funds.[5] The balance of the funds distributed in FY 2017 ($259 million) came from 48 other distribution funds comprised of 28 Fair Funds ($242 million) and 20 Disgorgement Funds ($17 million).

Individual Accountability

Individual accountability is critical to an effective enforcement program. In FY 2017, 73 percent of the Commission's standalone actions involved charges against one or more individuals, the same percentage as in FY 2016 (excluding the 84 actions attributable to the MCDC Initiative).[6]

Relief Obtained

In every enforcement action, the Division seeks appropriately tailored sanctions that further enforcement goals. In addition to disgorgement and penalties, there are a wide array of potential remedies available. In each case, the Division seeks those remedies that will be the most meaningful. Some of these remedies are discussed in more detail below.

Trading Suspensions

Under the federal securities laws, the Commission can suspend trading in a stock for 10 days and generally prohibit a broker-dealer from soliciting investors to buy or sell the stock again until certain reporting requirements are met. Trading suspensions are a significant enforcement tool and greatly enhance our ability to protect investors from possible fraud. In FY 2017, the Commission suspended trading in the securities of 309 issuers, a 55 percent increase over FY 2016, in order to combat potential market manipulation and microcap fraud threats to investors.

3 *SEC v. CR Intrinsic Investors, LLC, et al.*, No. 12-cv-8466 (S.D.N.Y.).

4 *JPMorgan Chase & Co.*, Administrative Proceeding File No. 3-15507.

5 *Credit Suisse Securities USA, LLC, et al.*, Administrative Proceeding File No. 3-15098

6 When MCDC-related actions are included in FY 2016's count, 61 percent of the Commission's standalone actions involved charges against one or more individuals.

Court-Ordered Asset Freezes

Court-ordered prejudgment relief in the form of asset freezes is important to the Commission's ability to protect investors. These freezes prevent alleged wrongdoers from dissipating assets that could be distributed to harmed investors. Wrongdoers often are adept at hiding and moving assets offshore, and the Commission's ability to obtain meaningful financial remedies, and to return money to harmed investors, therefore may depend on the ability to obtain an asset freeze at an early stage. These circumstances require seeking federal court action on an emergency basis. In FY 2017, the Commission sought 35 court-ordered asset freezes, a slight increase from FY 2016, when the Commission sought 33 asset freezes.

Bars and Suspensions Imposed

Bars and suspensions also are invaluable tools. One of the most important things that the Commission can do proactively to protect investors and the market is to remove bad actors from positions where they can engage in future wrongdoing. Bars and suspensions are the means by which the Commission prevents wrongdoers from serving as officers or directors of public companies, dealing in penny stocks, associating with registered entities such as broker-dealers and investment advisers, or appearing or practicing before the Commission as accountants or attorneys.

Enforcement actions resulted in over 625 bars and suspensions of wrongdoers in FY 2017 and over 650 bars and suspensions in FY 2016.

Noteworthy Enforcement Actions

While the Division's efforts resulted in many noteworthy enforcement actions in FY 2017, the matters described below give a sense of some of the actions the Commission brought in areas of the Division's greatest focus, as well as actions in other areas to demonstrate the breadth of the landscape the Division covers.

In FY 2017, the Commission brought charges against:

Direct Impact on Retail Investors and Conduct of Registrants

- Thirteen individuals allegedly involved in two Long Island-based cold calling scams that bilked more than 100 victims out of more than $10 million through high-pressure sales tactics and lies about penny stocks.[7]
- Twenty-seven individuals and entities behind various alleged stock promotion schemes that left investors with the impression they were reading independent, unbiased analyses on investing websites while writers actually were being secretly compensated for touting company stock.[8]
- Barclays Capital for charging improper advisory fees and mutual fund sales charges to clients, who were overcharged by nearly $50 million. The firm agreed to pay more than $97 million in disgorgement and penalties to settle the Commission's claims.[9]

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7 www.sec.gov/news/press-release/2017-124.

8 www.sec.gov/news/press-release/2017-79.

9 www.sec.gov/news/press-release/2017-98.

- Morgan Stanley Smith Barney related to single inverse ETF investments it recommended to advisory clients. The firm agreed to pay an $8 million penalty and admit wrongdoing to settle these charges.[10]
- The investment services subsidiary of SunTrust Banks for collecting more than $1.1 million in avoidable fees from clients by improperly recommending more expensive share classes of various mutual funds when cheaper shares of the same funds were available. The firm agreed to pay a $1.1 million penalty to settle the charges, and separately began refunding the overcharged fees plus interest to affected clients after the Division's investigation began.[11]
- Investment management firm Pacific Investment Management Company for misleading investors about the performance of one its first actively managed exchange-traded funds and failing to accurately value certain fund securities. The firm agreed to retain an independent compliance consultant and pay nearly $20 million to settle the charges.[12]
- BNY Mellon for miscalculating its risk-based capital ratios and risk-weighted assets reported to investors. The firm agreed to pay a $6.6 million penalty.[13]
- Three New York-based brokers for allegedly making unsuitable recommendations that resulted in substantial losses to customers and hefty commissions for the brokers. One of the brokers agreed to pay more than $400,000 to settle the charges.[14]
- Two New York-based brokers with allegedly fraudulently using an in-and-out trading strategy that was unsuitable for customers in order to generate substantial commissions for themselves.[15]

Cyber-Related Misconduct

- Three Chinese traders for allegedly trading on hacked, nonpublic, market-moving information stolen from two prominent law firms, making almost $3 million in illegal profits.[16]
- A Virginia-based mechanical engineer for allegedly scheming to manipulate the price of Fitbit stock by making a phony regulatory filing.[17]

Insider Trading

- A partner at a Hong Kong-based private equity firm who allegedly amassed more than $29 million in illegal profits by insider trading in advance of the April 2016 acquisition of DreamWorks Animation SKG Inc. by Comcast Corp.[18]
- A former government employee turned political intelligence consultant and three others for engaging in an alleged insider trading scheme involving tips of nonpublic information about government plans to cut Medicare reimbursement rates, which affected the stock prices of certain publicly traded medical providers or suppliers.[19]

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10 www.sec.gov/news/pressrelease/2017-46.html.
11 www.sec.gov/news/press-release/2017-165.
12 www.sec.gov/news/pressrelease/2016-252.html.
13 www.sec.gov/news/pressrelease/2017-9.html.
14 www.sec.gov/news/press-release/2017-180.
15 www.sec.gov/news/pressrelease/2017-2.html.
16 www.sec.gov/news/pressrelease/2016-280.html.
17 www.sec.gov/news/press-release/2017-107.
18 www.sec.gov/news/pressrelease/2017-44.html.
19 www.sec.gov/news/press-release/2017-109.

Issuer Reporting and Disclosure Issues and Auditor Misconduct

- Ernst & Young LLP, which agreed to pay more than $11.8 million to settle claims related to failed audits of an oil services company that used deceptive income tax accounting to inflate earnings, as well as two of the firm's partners, who agreed to suspensions from practicing before the Commission.[20]
- KPMG LLP and an audit partner for failing to properly audit the financial statements of an oil and gas company, resulting in investors being misinformed about the energy company's value. The firm agreed to pay more than $6.2 million to settle the charges, and the audit partner agreed to a suspension from appearing and practicing before the Commission.[21]
- Canadian-based oil and gas company Penn West Petroleum Ltd. and three of its former top finance executives for their roles in an extensive, multi-year accounting fraud.[22]

Other Noteworthy Actions

- Petrochemical manufacturer Braskem S.A. for creating false books and records to conceal millions of dollars in illicit bribes paid to Brazilian government officials to win or retain business. The entity settled by paying $957 million to the Commission, the U.S. Department of Justice (DOJ), and authorities in Brazil and Switzerland.[23]
- Sweden-based telecommunications provider Telia Company AB related to violations of the Foreign Corrupt Practices Act (FCPA) to win business in Uzbekistan, which the entity settled by paying $956 million to the Commission, DOJ, and Dutch and Swedish law enforcement.[24]
- A former official of the nation's third-largest public pension fund and two brokers accused of orchestrating a pay-to-play scheme to steer billions of dollars to certain firms in exchange for luxury gifts, lavish vacations, and tens of thousands of dollars spent on illegal narcotics and prostitutes.[25]
- Citadel Securities LLC, which agreed to pay $22.6 million to settle claims that its business unit handling retail customer orders from other brokerage firms made misleading statements to them about the way it priced trades.[26]
- A businessman and two companies for defrauding investors in a pair of so-called ICOs purportedly backed by investments in real estate and diamonds.[27]
- A Ukraine-based trading firm, Avalon FA Ltd., accused of manipulating the U.S. markets hundreds of thousands of times and the New York-based brokerage firm of Lek Securities and its CEO who allegedly helped make it possible.[28]

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20 www.sec.gov/news/pressrelease/2016-219.html.
21 www.sec.gov/news/press-release/2017-142.
22 www.sec.gov/news/press-release/2017-120.
23 www.sec.gov/news/pressrelease/2016-271.html.
24 www.sec.gov/news/press-release/2017-171.
25 www.sec.gov/news/pressrelease/2016-272.html.
26 www.sec.gov/news/pressrelease/2017-11.html.
27 www.sec.gov/news/press-release/2017-185-0.
28 www.sec.gov/news/pressrelease/2017-63.html.

APPENDIX

Breakdown of Classification of Standalone Enforcement Actions				
	2017		2016	
	Actions	Pct	Actions	Pct
Issuer Reporting / Audit & Accounting	95	21%	93	17%
Securities Offering	94	21%	90	16%
Inv. Adviser / Inv. Company	82	18%	98	18%
Broker Dealer	53	12%	61	11%
Market Manipulation	41	9%	30	5%
Insider Trading	41	9%	45	8%
Public Finance Abuse	17	4%	97	18%
FCPA	13	3%	21	4%
Miscellaneous	7	2%	9	2%
Transfer Agent	3	1%	2	0%
NRSRO	0	0%	2	0%
Total	**446**	**100%**	**548**	**100%**

Disgorgement Orders over $100 Million Entered in Fiscal Year 2017	
Party	Link to Release
Steve Chen, et al.	www.sec.gov/news/pressrelease/2015-227.html
JPMorgan Chase & Co.	www.sec.gov/news/pressrelease/2016-241.html
Braskem S.A.	www.sec.gov/news/pressrelease/2016-271.html
Teva Pharmaceutical Industries Ltd.	www.sec.gov/news/pressrelease/2016-277.html
Telia Company AB	www.sec.gov/news/press-release/2017-171

Penalty Orders over $50 Million Entered in Fiscal Year 2017	
Party	Link to Release
Ming Xu	www.sec.gov/news/press-release/2014-60
Credit Suisse AG	www.sec.gov/news/pressrelease/2016-210.html
State Street Bank & Trust Co.	www.sec.gov/litigation/admin/2016/ic-32390-s.pdf

Disgorgement Orders over $100 Million Entered in Fiscal Year 2016	
Party	Link to Release
Trevor G. Cook, et al.	www.sec.gov/litigation/litreleases/2009/lr21313.htm
Louis V. Schooler	www.sec.gov/news/press-release/2012-2012-183htm
JPMorgan Chase Bank, N.A., et al.	www.sec.gov/news/pressrelease/2015-283.html
The Bank of New York Mellon	www.sec.gov/litigation/admin/2016/ic-32151-s.pdf
VimpelCom Ltd.	www.sec.gov/news/pressrelease/2016-34.html
Och-Ziff Capital Management Group LLC, et al.	www.sec.gov/news/pressrelease/2016-203.html

Penalty Orders over $50 Million Entered in Fiscal Year 2016	
Party	Link to Release
Merrill Lynch, Pierce, Fenner & Smith Inc., et al.	www.sec.gov/news/pressrelease/2016-128.html
Weatherford International PLC, et al.	www.sec.gov/news/pressrelease/2016-194.html
JPMorgan Chase Bank, N.A., et al.	www.sec.gov/news/pressrelease/2015-283.html
Monsanto Company	www.sec.gov/news/pressrelease/2016-25.html
VimpelCom Ltd.	www.sec.gov/news/pressrelease/2016-34.html
Och-Ziff Capital Management Group LLC, et al.	www.sec.gov/news/pressrelease/2016-203.html

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SEC Enforcement Activity: Public Companies and Subsidiaries

Fiscal Year 2017 Update

ANALYSIS AND TRENDS

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Executive Summary FY 2017

New enforcement actions against public companies and subsidiaries decreased by 33 percent in fiscal year 2017 compared to fiscal year 2016.[1] This report highlights findings based on data from the Securities Enforcement Empirical Database (SEED), a collaboration between the NYU Pollack Center for Law & Business and Cornerstone Research.

Filings

- The SEC filed 62 new enforcement actions against public companies and subsidiaries (public company–related defendants) in fiscal year 2017, a 33 percent decrease compared to fiscal year 2016. (page 3)
- There were 45 actions filed in the first half of FY 2017 but only 17 in the second half. The timing of this drop corresponds with leadership changes at the SEC. (page 3)

Allegations

- Issuer Reporting and Disclosure continued to be the most frequent type of allegation against public company–related defendants. (page 4)
- There were 10 FCPA actions filed against public company–related defendants in FY 2017, but only two were filed since February 2017. (page 4)

Industry

- Manufacturing defendants and Finance, Insurance, and Real Estate defendants were most commonly targeted in FY 2017 public company–related actions, accounting for 74 percent of all actions. (page 5)

Timing of Resolutions

- In FY 2017, 61 of the 62 actions filed were resolved on the same day they were initiated. (page 7)

We saw significant declines in several activity measures, including overall filings against public company and subsidiary defendants, in the second half of FY 2017 versus the first half.

Stephen Choi
Murray and Kathleen Bring Professor of Law
Director of the Pollack Center
New York University

Cooperation

- The percentage of public company–related defendants that cooperated with the SEC declined in FY 2017. (page 8)

Monetary Settlements

- In FY 2017, the monetary settlements imposed in the 58 public company–related actions with settlements totaled $1.2 billion, almost all of it in the first half of the year. (page 9)
- The largest monetary settlement for public company–related actions in FY 2017 was $236 million and involved FCPA violations. (page 10)

Key Takeaways FY 2010 to FY 2017

- There were 45 actions filed against public company–related defendants in the first half of FY 2017 and 17 actions filed in the second half—the largest semiannual decrease within a fiscal year since SEED began tracking data (FY 2010).
- In contrast, during FY 2012 through FY 2016, the number of actions increased in the second half of the fiscal year.
- In the first half of FY 2017, 63 percent of public company–related defendants cooperated with the SEC, while only 32 percent cooperated in the second half.
- The second-half percentage is the lowest level of cooperation since the first half of FY 2013, when 18 percent of defendants cooperated with the SEC. The semiannual average from FY 2010 through the first half of FY 2017 is 50 percent.
- Total monetary settlements against public company–related defendants also declined from the first half of FY 2017 to the second half, from $1 billion to $196 million.
- Penalties in the second half of FY 2017 accounted for only 16 percent of total settlements for the fiscal year—the lowest percentage (and dollar amount) for any half year since SEED began tracking data (FY 2010).

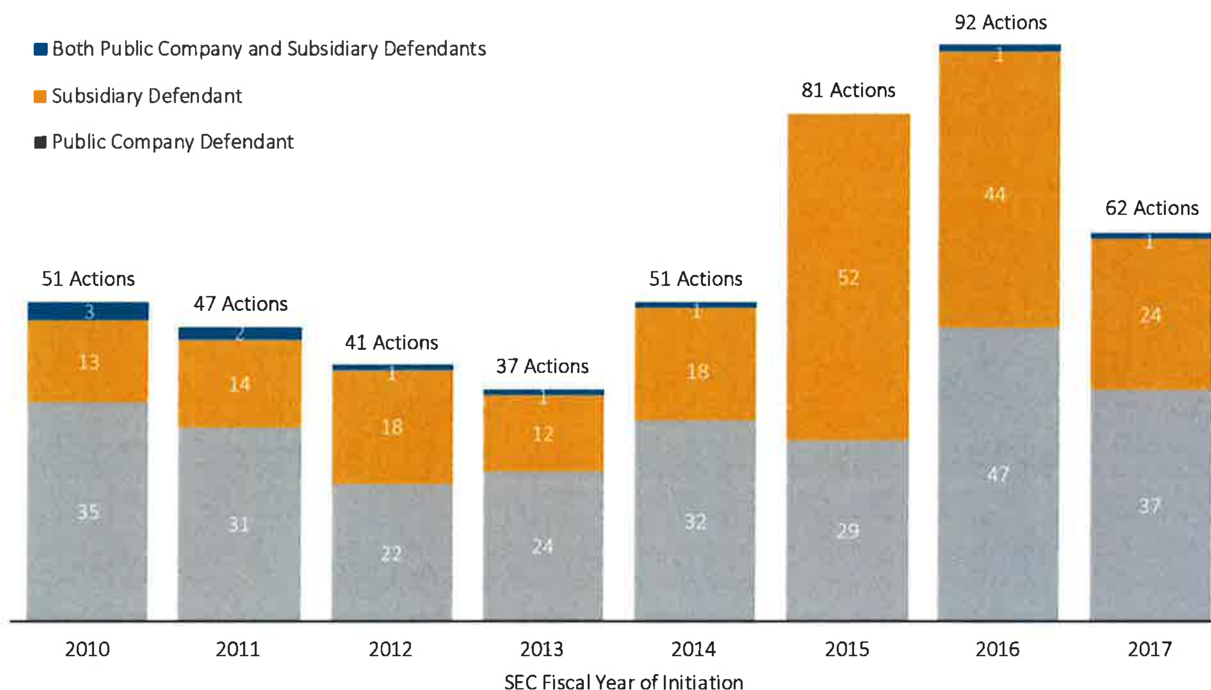
Actions filed against public company–related defendants declined in FY 2017 after three years of increases.

Number of Filings

- The SEC filed 62 new enforcement actions against public companies and subsidiaries in FY 2017.
- In the first half of FY 2017, the number of actions was on pace to match FY 2015 and FY 2016. In the second half of FY 2017, however, the number of actions declined dramatically.
- There were 45 actions filed in the first half of FY 2017 compared to 17 in the second half. The timing of the drop in public company–related filings corresponds with leadership changes at the SEC.[2]

The number of new enforcement actions declined 33 percent overall in FY 2017. From the first half to the second half, the decline was 62 percent.

Figure 1: Public Company–Related SEC Actions FY 2010–FY 2017



Source: Securities Enforcement Empirical Database (SEED)
Note: Relief defendants are not considered.

Classification of Allegations

- The SEC continued to focus on Issuer Reporting and Disclosure allegations in FY 2017.[3] At 39 percent, it was the most frequent allegation type against public company–related defendants.
- There were 10 actions involving FCPA allegations in FY 2017. Since February 2017, however, only two actions with FCPA allegations have been filed against public company–related defendants. This decrease coincides with the departure of Kara Novaco Brockmeyer, who had served as chief of the SEC Enforcement Division's FCPA Unit since 2011.[4]
- Investment Advisor/Investment Companies allegations were the most frequent type in the second half of FY 2017. This is consistent with SEC Chair Jay Clayton's testimony that the Commission has increased its focus on registered entities and intends to focus more on investment professionals.[5]

Of the 10 FCPA actions filed in FY 2017, eight were filed in the first four months.

Figure 2: Heat Map of Allegations against Public Company–Related Defendants FY 2010–FY 2017

Allegation Type	SEC Fiscal Year of Initiation								
	Average 2010–2016	2010	2011	2012	2013	2014	2015	2016	2017
Issuer Reporting and Disclosure	36%	43%	32%	29%	49%	49%	23%	26%	39%
Investment Advisor/ Investment Companies	10%	6%	4%	10%	14%	10%	6%	21%	21%
Foreign Corrupt Practices Act	20%	24%	36%	24%	14%	14%	12%	20%	16%
Broker Dealer	10%	10%	13%	12%	0%	14%	12%	12%	13%
Securities Offering	7%	6%	4%	7%	19%	4%	1%	9%	5%
Municipal Securities/ Public Pensions	11%	4%	11%	10%	0%	4%	40%	9%	0%
Market Manipulation	2%	0%	0%	5%	5%	2%	0%	0%	0%
Other	3%	8%	0%	2%	0%	4%	5%	4%	6%
Number of Actions	57	51	47	41	37	51	81	92	62

Legend: 0% | 1–10% | 11–20% | 21–50% | 51–100%

Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. Percentages may not add to 100 percent due to rounding. "Other" includes actions categorized by the SEC as "Other" or "Transfer Agent."

Industry

SEED classifies defendants by their Standard Industrial Classification (SIC) codes.

- In FY 2017, actions with public company–related defendants in the Finance, Insurance, and Real Estate division accounted for 42 percent of all public company–related actions. While this is a decrease from FY 2016, this industry division still accounts for the highest percentage of public company–related actions.
- Most actions against Finance, Insurance, and Real Estate defendants targeted Commercial Banks (50 percent) or Securities Brokers, Dealers & Flotation Companies (31 percent), consistent with historical trends.
- In FY 2017, the percentage of public company–related actions against Manufacturing defendants almost doubled from 18 percent to 32 percent.
- Manufacturing defendants spanned a diverse set of 14 SIC industry groups. Drugs manufacturers and Medical Instruments and Supplies manufacturers were the two most targeted groups in this industry division.

Actions against Manufacturing defendants and Finance, Insurance, and Real Estate defendants accounted for a combined 74 percent of public company–related actions in FY 2017.

Figure 3: Heat Map of Industries of Public Company–Related Defendants FY 2010–FY 2017

SIC Industry Division	SEC Fiscal Year of Initiation								
	Average 2010–2016	2010	2011	2012	2013	2014	2015	2016	2017
Finance, Insurance, and Real Estate	49%	35%	34%	54%	46%	53%	63%	59%	42%
Manufacturing	27%	37%	36%	32%	27%	20%	17%	18%	32%
Services	10%	22%	15%	7%	5%	12%	9%	3%	8%
Transportation, Communications, Electric, Gas and Sanitary Service	2%	0%	2%	2%	5%	0%	0%	4%	6%
Other	12%	6%	13%	5%	16%	16%	11%	15%	11%
Number of Actions	57	51	47	41	37	51	81	92	62

Legend: 0% | 1–10% | 11–20% | 21–50% | 51–100%

Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. SIC industry divisions are as of the SEC enforcement action initiation date, or otherwise are as of the latest available date within the five-year period preceding the initiation. Subsidiary defendants are categorized according to the SIC industry division of their public parent company. "Other" contains all SIC industry divisions that were not in the top four by action count for fiscal year 2017. Percentages may not add to 100 percent due to rounding.

- From FY 2010 through FY 2017, the most common allegation in public company–related actions (Issuer Reporting and Disclosure) was spread relatively consistently across Finance, Insurance, and Real Estate; Manufacturing; and Services defendants.
- Manufacturing defendants faced the majority of FCPA allegations (64 percent), while Finance, Insurance, and Real Estate defendants accounted for only 6 percent.

Finance, Insurance, and Real Estate defendants dominated every major allegation type except Issuer Reporting and Disclosure and FCPA.

Figure 4: Heat Map of Allegations against Public Company–Related Defendants by Industry FY 2010–FY 2017

SIC Industry Division	Average by SIC Industry Division	Allegation Type							
		Issuer Reporting and Disclosure	Foreign Corrupt Practices Act	Investment Advisor/ Investment Companies	Municipal Securities/ Public Pensions	Broker Dealer	Securities Offering	Market Manipulation	Other
Finance, Insurance, and Real Estate	65%	24%	6%	91%	94%	98%	76%	80%	53%
Manufacturing	16%	34%	64%	4%	2%	0%	7%	0%	21%
Services	6%	18%	8%	4%	2%	2%	7%	0%	11%
Mining	3%	4%	12%	0%	0%	0%	0%	0%	5%
Other	9%	19%	10%	2%	2%	0%	10%	20%	11%
Total Number of Actions FY 2010–FY 2017	462	159	89	56	53	52	29	5	19

Legend: 0% | 1–10% | 11–20% | 21–50% | 51–100%

Source: Securities Enforcement Empirical Database (SEED)

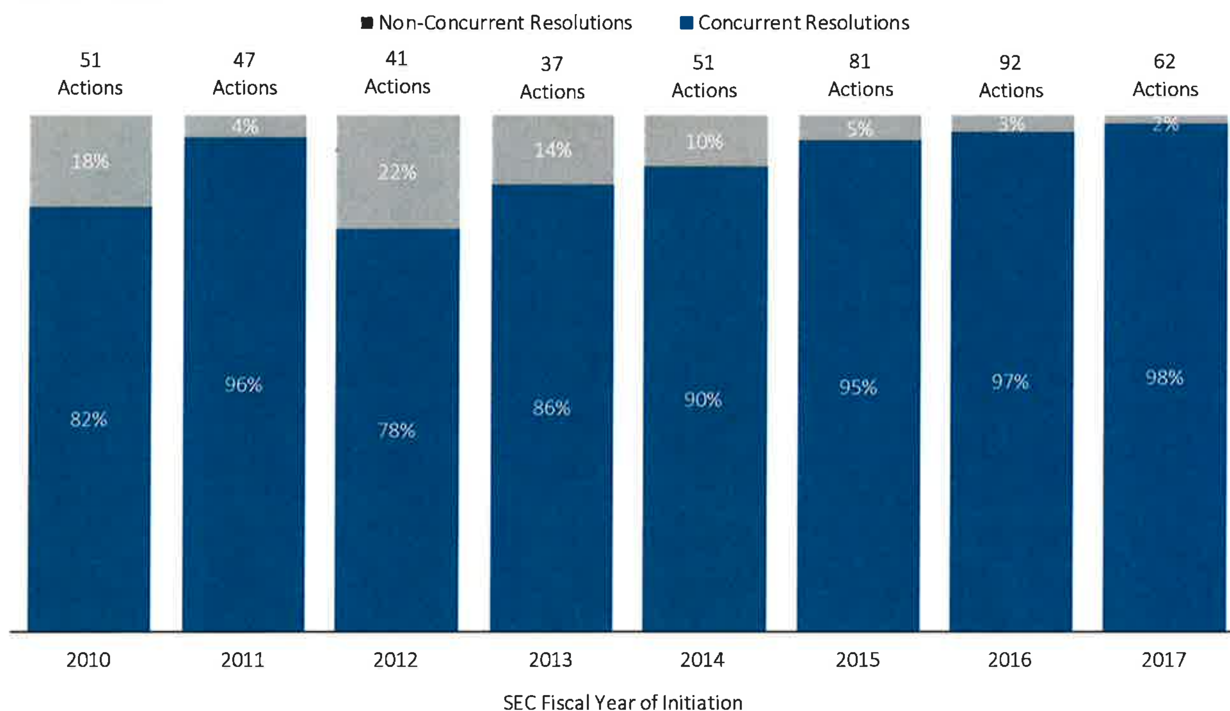
Note: Relief defendants are not considered. SIC industry divisions are as of the SEC enforcement action initiation date, or otherwise are as of the latest available date within the five-year period preceding the initiation. Subsidiary defendants are categorized according to the SIC industry division of their public parent company. "Other" SIC Industry Division contains all SIC industry divisions that were not in the top four by action count. "Other" Allegation Type includes actions categorized by the SEC as "Other" or "Transfer Agent." Percentages may not add to 100 percent due to rounding.

Timing of Resolutions

- In FY 2017, 98 percent of public company–related defendants resolved SEC actions on the same day they were initiated (concurrent resolutions). The FY 2010–FY 2016 median was 90 percent.
- Historically, concurrent resolutions have been more common in administrative proceedings than civil actions. From FY 2010 to FY 2017, 98 percent of administrative proceedings had concurrent resolutions, whereas 77 percent of civil actions had concurrent resolutions.
- From FY 2010 through FY 2017, 32 actions (out of 462 actions) had non-concurrent resolutions, and six actions were unresolved as of the end of FY 2017. Two of the actions with non-concurrent resolutions were resolved at trial.
- The median time to resolution for the 32 actions with non-concurrent resolutions was 237 days.

The majority of non-concurrent resolutions involved Issuer Reporting and Disclosure allegations.

Figure 5: Timing of Resolutions for Actions with Public Company–Related Defendants
FY 2010–FY 2017



Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. Actions that are initiated and resolved on the same day are concurrent resolutions.

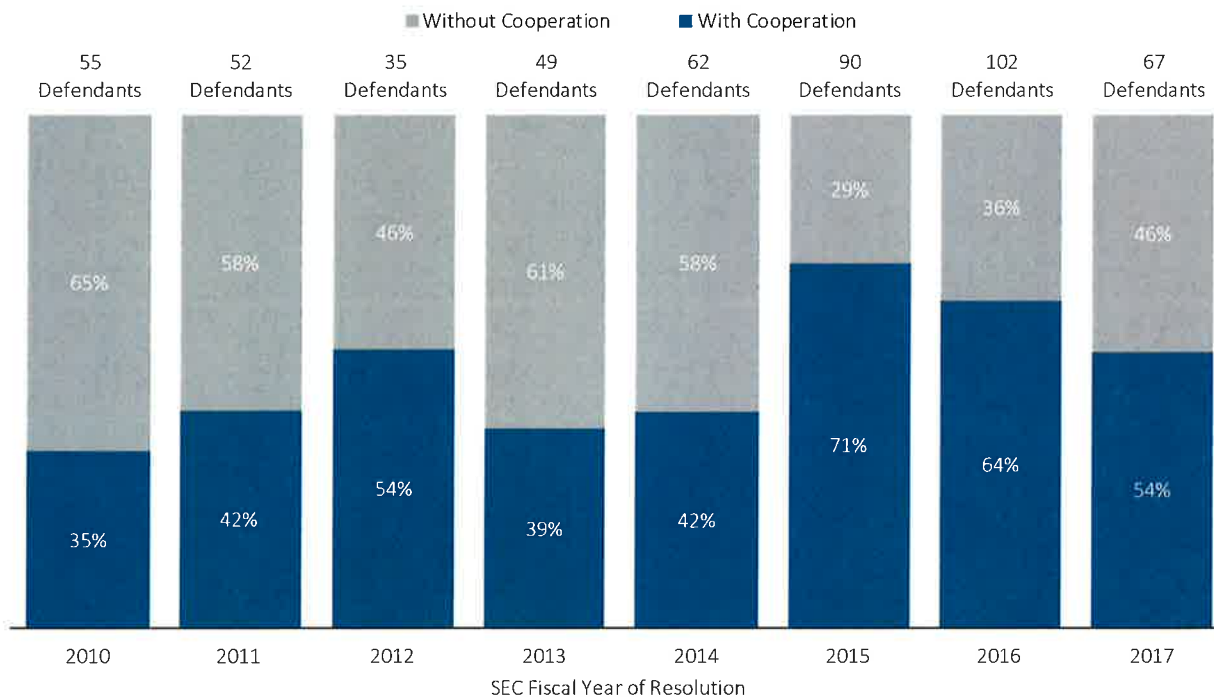
Cooperation Noted in Settlements

The SEC considers four factors when negotiating a settlement with a cooperating defendant: "self-policing, self-reporting, remediation, and cooperation."[6] SEED measures the latter three factors as an indication of whether a public company–related defendant cooperated with the SEC based on whether the SEC acknowledges voluntary reporting or explicitly mentions "remediation" or "cooperation" by the defendant in the settlement announcement.

- In FY 2017, 54 percent of public company–related defendants cooperated with the SEC, compared to FY 2015 (71 percent) and FY 2016 (64 percent).
- From FY 2010 to FY 2017, the percentage of cooperation was highest among defendants in the Services (60 percent); Manufacturing (58 percent); and Finance, Insurance, and Real Estate (52 percent) industries.
- Defendants cooperated most in actions involving allegations related to Municipal Securities/Public Pensions (87 percent) and FCPA violations (61 percent).

Between the first and second halves of FY 2017, the percentage of cooperation by public company–related defendants declined from 63 percent to 32 percent.

Figure 6: Cooperation Noted in Settlements with Public Company–Related Defendants
FY 2010–FY 2017



Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. Actions resolved through trial are excluded. An action with cooperation indicates a defendant's cooperation with the SEC prior to the non-trial resolution of that action. The words "cooperation" or "remediation" must be mentioned in the document detailing the non-trial resolution, or the SEC must acknowledge voluntary reporting by the defendant. Settlements are counted at the defendant level.

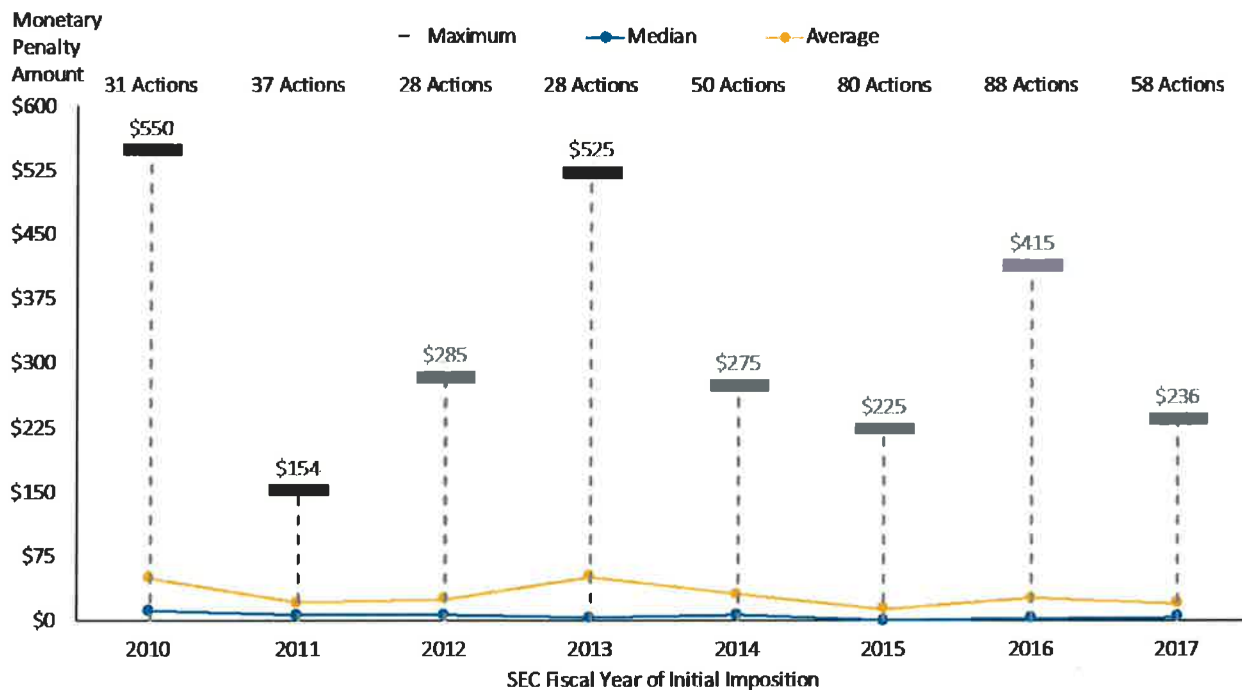
Monetary Settlements

- In FY 2017, the monetary settlements imposed in the 58 public company–related actions with settlements totaled $1.2 billion.[7]
- For public company–related actions resolved in FY 2017, 89 percent had monetary penalties. This was similar to the FY 2016 and FY 2015 figures of 96 percent and 95 percent, respectively.
- The percentage of resolved actions with monetary settlements dropped from the first half of FY 2017 (94 percent) to the second half (78 percent).
- The eight monetary settlements imposed in public company–related FCPA actions in the first half of FY 2017 totaled $567.4 million. The two monetary settlements involving FCPA violations in the second half of FY 2017 totaled only $42.2 million.[8]

Total monetary settlements declined from $1 billion in the first half of FY 2017 to $196 million in the second half.

Figure 7: Monetary Settlements Imposed in Public Company–Related Actions
FY 2010–FY 2017

(Dollars in Millions)



Source: Securities Enforcement Empirical Database (SEED)

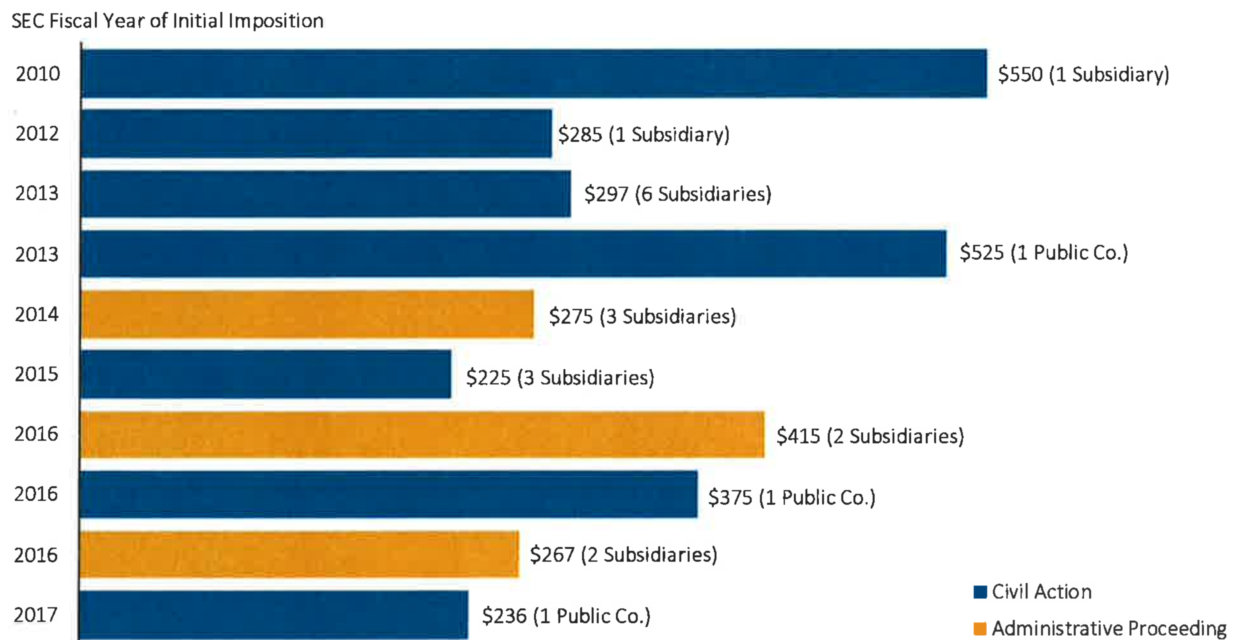
Note: Relief defendants are not considered. Total monetary settlements exclude monetary settlements imposed exclusively on individuals, nonpublic companies, and nonpublic subsidiaries.

- From FY 2010 through FY 2017, the top 10 monetary settlements imposed in public company–related actions accounted for almost a third of total penalties.
- The top 10 monetary settlements totaled over $3.4 billion. Seven of these involved financial institutions.
- Actions with non-concurrent resolutions were less likely to have monetary settlements. From FY 2010 through FY 2017, 71 percent of actions with non-concurrent resolutions had monetary settlements, compared to 88 percent of actions with concurrent resolutions.
- Eight of the top 10 settlements had concurrent resolutions. The two actions with non-concurrent resolutions had monetary settlements of $550 million (in FY 2010) and $225 million (in FY 2015).

The largest monetary settlement in FY 2017 was $236 million and involved FCPA violations.

Figure 8: Top 10 Monetary Settlements Imposed in Public Company–Related Actions FY 2010–FY 2017

(Dollars in Millions)



Source: Securities Enforcement Empirical Database (SEED)

Note: Relief defendants are not considered. Total monetary settlements exclude monetary settlements imposed exclusively on individuals, nonpublic companies, and nonpublic subsidiaries.

Research Sample

- The Securities Enforcement Empirical Database (SEED), a collaboration between the NYU Pollack Center for Law & Business and Cornerstone Research, identifies 462 SEC enforcement actions initiated against 419 public company defendants and their subsidiaries between October 1, 2009, and September 30, 2017 (http://seed.law.nyu.edu).
- The sample used for the majority of this report is referred to as "enforcement actions initiated against public company–related defendants" and includes only those enforcement actions with public companies or their subsidiaries listed explicitly as defendants. The sample does not include cases where the allegations relate exclusively to delinquent filings. In addition, the sample excludes enforcement actions filed against individual defendants employed at either public companies or subsidiaries of public companies.
- Public companies are defined as those that traded on a major U.S. exchange as identified by the Center for Research in Security Prices (CRSP) at the time the enforcement action was initiated, or otherwise within the five-year period preceding the initiation. Thus, public companies that traded over-the-counter or on major non-U.S. exchanges are excluded, as are companies that did not become publicly traded until after the enforcement action was initiated.
- Subsidiaries are defined as those entities that had a publicly traded parent company at the time the enforcement action was initiated or otherwise within the five-year period preceding the initiation. The public parent companies of subsidiaries were identified as those cited in the enforcement action document initiating proceedings when available, or those identified through SEC filings if no parent company was mentioned in the initial enforcement action document.

SEED provides easily searchable and verified data on SEC enforcement actions to researchers, counsel, and corporations.

Endnotes

[1] SEC fiscal years begin on October 1 of the prior year and end on September 30. SEC fiscal year 2010 through fiscal year 2017 spans October 1, 2009, to September 30, 2017.

[2] "Jay Clayton Sworn in as Chairman of SEC," SEC Press Release 2017-94, May 4, 2017, https://www.sec.gov/news/press-release/2017-94; "Enforcement Director Andrew J. Ceresney to Leave SEC," SEC Press Release 2016-259, December 8, 2016, https://www.sec.gov/news/pressrelease/2016-259.html; "SEC Names Stephanie Avakian and Steven Peikin as Co-Directors of Enforcement," SEC Press Release 2017-113, June 8, 2017, https://www.sec.gov/news/press-release/2017-113; "Chief Economist and Division of Economic and Risk Analysis Director Mark Flannery to Leave SEC," SEC Press Release 2016-254, December 2, 2016, https://www.sec.gov/news/pressrelease/2016-254.html.

[3] "The SEC Enforcement Division's Focus on Auditors and Auditing," Andrew Ceresney, Director, Division of Enforcement, U.S. Securities and Exchange Commission, September 22, 2016, https://www.sec.gov/news/speech/ceresney-enforcement-focus-on-auditors-and-auditing.html.

[4] On November 2, 2017, the SEC named Charles Cain as the new chief of the FCPA Unit. Mr. Cain was the deputy chief of the FCPA Unit since 2011 and served as the Unit's acting chief following Ms. Brockmeyer's departure in April 2017. "Kara Novaco Brockmeyer, Chief of FCPA Unit, to Leave SEC After 17 Years of Service," SEC Press Release 2017-76, April 4, 2017, https://www.sec.gov/news/press-release/2017-76; "Charles Cain Named Chief of Foreign Corrupt Practices Unit," SEC Press Release 2017-206, November 2, 2017, https://www.sec.gov/news/press-release/2017-206.

[5] "SEC Chairman Testifies about SEC's Direction and 2016 Cyberattack," October 3, 2017, http://www.lexissecuritiesmosaic.com/net/Blogwatch/Blogwatch.aspx?ID=31400.

[6] "The SEC's Cooperation Program: Reflections on Five Years of Experience," Andrew Ceresney, Director, Division of Enforcement, U.S. Securities and Exchange Commission, May 13, 2015, https://www.sec.gov/news/speech/sec-cooperation-program.html.

[7] Total monetary settlements include disgorgement, prejudgment interest, civil penalties, and other monetary penalties imposed in public company–related actions. Total monetary settlements exclude any monetary penalties imposed exclusively on individuals, nonpublic companies, and nonpublic subsidiaries.

[8] In the second half of 2017, there was a settlement for an action with FCPA allegations involving a company not traded on a major U.S. exchange and, thus, not included in SEED. The settlement with the SEC involved a monetary settlement of $457 million. The company also settled with the U.S. Department of Justice and the settlement included a monetary penalty of $508 million.

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The views expressed in this report are solely those of the authors, who are responsible for the content, and do not necessarily represent the views of the NYU Pollack Center for Law & Business or Cornerstone Research.

The authors request that you reference the NYU Pollack Center for Law & Business and Cornerstone Research in any reprint of the information or figures included in this report.

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Wall Street LAWYER
Securities in the Electronic Age

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THE NEW *NATIONAL TASK FORCE ON LAWYER WELL-BEING* REPORT ON ADDICTION IN THE LEGAL INDUSTRY: AN INTERVIEW WITH CO-AUTHOR PATRICK KRILL

In mid-August, the National Task Force on Lawyer Well-Being published its report on the impact of addiction in the legal profession and outlined the steps the profession must make towards much-needed improvement in how it views and treats drug and alcohol addiction and mental health issues among lawyers. Patrick Krill is an attorney and a licensed & board-certified alcohol and drug counselor, the founder and principal of Krill Strategies, and one of the co-authors of the report.

He spoke with *Wall Street Lawyer* about the report, what its findings mean to the legal industry and some positive first steps that law firms and legal departments can take when they see a colleague in distress.

Wall Street Lawyer*: There was a lot of news that came out of this report. Could you give us a little bit of a background of where this report came from, and what was the impetus behind its creation?*

Patrick Krill: As you probably recall last year, in 2016, there was a study published that was a joint effort by the American Bar Association and the Hazelden Betty Ford Foundation. I was actually the lead author of that study, and that demonstrated that there is a significant level of problem drinking and mental health distress, specifically depression and anxiety, in the legal profession.

With the publication of that report in tandem with the publication of a study on law students, which demonstrated similar levels of elevated distress and limited help-seeking, a lot of discussion was initiated last year. So, attorney behavioral health, if you will, became something of a hot topic for the profession.

Some colleagues and I, both within the American Bar Association and outside, came together following the publication of those two studies, and had a conversation about what do we do next? How do we continue the momentum that has been built with this new awareness around the levels of problem drinking, depression, anxiety, etc.? And it really was a "what's next?" type plan that lead us to the formation of the National Task Force on Lawyer Well-Being. It was the intent really from the outset to develop a cohesive and coherent strategy for helping the profession overcome

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Wall Street Lawyer: You can certainly see that, and certainly see how the legal culture and the structural impediments to seeking help could be very strong in the legal industry. Now that the report is out, what would you like to see happen, going forward with this?

Patrick Krill: Well, I'm encouraged by the amount of support that this report has received within the various leadership channels in the profession. For example, the report has already been endorsed by the National Conference of Chief Justices. And as you probably know, Chief Justices in respective individual states play very significant roles, not only in determining how lawyers are regulated and what sort of expectations around the practice of law are in a given state, but they also help to set the tone. In fact, they can really have a significant influence on the practice of law in a state.

Now that the Conference of Chief Justices has come out and endorsed this report, and now that they are adopting an action plan to disseminate it broadly and widely throughout their individual states, I have a sense that that is going to have essentially a trickle-down effect throughout the bar associations and various other leadership groups within individual states.

At the same time, we are working hard to raise awareness about the report within the private sector and in the legal profession as a whole, including within law firms and law schools. Our hope is that there will be a lot of similar adoption and endorsement of the report. People will use it, they'll follow the recommendations, not only for the general profession, but also the recommendations that are very specific to their respective sort of domain within the profession.

Wall Street Lawyer: Well, we wish these efforts a lot of success, and we believe the report will open a lot of peoples' eyes to this problem.

SEC ALJS BEFORE THE SUPREME COURT: WILL THE COURT TAKE THE ISSUE?

By Thomas O. Gorman

Thomas O. Gorman is a Partner in the Washington, D.C. office of Dorsey and Whitney. He also publishes SEC Actions (www.secactions.com), a blog that focuses on the Securities and Exchange Commission. This article is based on a blog post that was published on September 10. Contact: gorman.tom@dorsey.com.

The validity of the Securities and Exchange Commission's (SEC's) administrative enforcement process and, in particular its Administrative Law Judges (ALJs), under the Constitution's Appointments Clause is a critical issue that the U.S. Supreme Court is considering for addition to its docket this term which will begin on the first Monday in October.[1]

The issues at stake are significant in view of the potential impact and remedies that might flow from a decision adverse to the Commission. (See *SEC Enforcement, ALJs and the Appointments Clause* in the June 2017 issue of *Wall Street Lawyer*.)

To date, the U.S. Court of Appeals have been split. The U.S. Court of Appeals for the Tenth Circuit held that the appointments for SEC ALJs fail Constitutional muster in last year's *Brandimere v. SEC*[2] decision; six years earlier, the D.C. Circuit had reached the opposite conclusion in *Landry v. FDIC*.[3] When the question was recently heard *en banc* in *Raymond J. Lucia Cos. Inc. v. SEC*, [4] the D.C. Circuit Court split, leaving the prior panel decision upholding the appointment of SEC ALJs in place, following *Landry*.

On September 7, the Fifth Circuit's issued a decision in *Cornelius Campbell Burgess v. FDIC*, [5] which may add to the pressure on the Supreme Court to grant *certiorari* and resolve the question.

The *Burgess* ruling came out of an investigation

into Cornelius Campbell Burgess, a director and former president and CEO of Herring Bank. Burgess was investigated by the Federal Deposit Insurance Corporation (FDIC) for improper expense practices and the misuse of bank property. A hearing was held before an FDIC ALJ who subsequently issued findings of fact and conclusions of law. The FDIC Board largely adopted those findings and conclusions. An order was entered assessing a civil penalty and requiring the withdrawal of Burgess from the banking industry. In seeking review by the Circuit Court, Burgess requested a stay of the agency order. The Court granted the stay.

While the question of whether a stay should be issued depends on a multi-prong test, the critical factor is the merits. To obtain a stay the proponent must make a "'strong showing' that. . . [he] is likely to succeed on the merits of his petition for review, not just a 'mere possibility of relief.' " Here the merits hinge on a question under the Constitution's Appointments Clause and whether the FDIC ALJ was appointed in accordance with its requirements.

The Appointments Clause divides federal government personnel into three categories: Principal Officers, Inferior Officers, and Non-Officer Employees. Principal Officers must be appointed by the U.S. President with the advice and consent of the U.S. Senate. Inferior Officers may be appointed by the President, the Courts of Law or the Heads of Departments. Non-Officer Employees are classified as lesser functionaries, and their appointment is not governed by the Constitution.

A government worker is an Officer of the U.S. subject to the Clause if "he or she exercises 'significant authority pursuant to the laws of the United States,' the Fifth Circuit said in *Burgess*, quoting *Freytag v. Commissioner of Internal Revenue*,[6] a Supreme Court case decided in 1991. In *Freytag*, the Court held that a Special Trial Judge in the Article I U.S. Tax Court was an Inferior Officer subject to the Clause. Later, the D.C. Circuit Court on *Landry* concluded that FDIC ALJs were not—essentially the same issue raised by *Burgess*. The D.C. Circuit also reached the same conclusion as to SEC ALJs in *Raymond J. Lucia Cos.*

In this case, based on *Freytag*, the Fifth Circuit Court concluded "that Burgess has made a 'strong showing' that he is likely to succeed on the merits of his petition for review. In *Freytag*, the Supreme Court considered the Appointments Clause question as to Special Tax Court Judges (STJs). Under the applicable statute, in some cases STJs had the authority to decide the case; in others they did not. In the case before the Supreme Court, the STJ did not have the authority to enter a final judgment. Nevertheless, the Supreme Court concluded that the appointment of the STJ was subject to the clause. "In reaching this conclusion, the Court noted that (*i*) the position was 'established by law;' (*ii*) its 'duties, salary, and means of appointment. . . are specified by statute;' and (*iii*) the officeholder was empowered to 'exercise significant discretion' over 'important functions.' " Key was "the 'independent authority' that STJs exercised when authorized to enter a final judgment in some cases [which] rendered them 'Inferior Officers' for all purposes."

Based on *Freytag*, the Fifth Circuit Court rejected the holding of *Landry* "that final decision-making authority" is a necessary condition for Officer status. Rather, the Court concluded that a government worker is an "Inferior Officer" subject to the Appointments Clause if his office entails significant duties and discretion. To assess this question the court must consider: *i*) if the office was established by law; *ii*) if the duties, salary and means of appointment are specified by statute; and *iii*) if the office holder can exercise significant discretion in carrying out important functions.

In this case the "broad authority to preside over agency functions. . . to preside over agency adjudica-

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tions and issue recommendations closely resembles the authority wielded by United States Commissioner—the forerunners of Magistrate Judges—who the Supreme Court held were officers," the Fifth Circuit stated, citing *Go-Bart Importing Co. v. U.S.*[7] Viewed in this context, the Court ruled that Petitioner Burgess has made the required substantial showing on the merits necessary to support an application for a stay.

More importantly, the decision may force the Supreme Court to weigh in on the issue of SEC ALJs that is at the heart of this Circuit split.

ENDNOTES:

[1]Petition for Writ of Certiorari, *Raymond J. Lucia v. SEC*, No. 17-130).

[2]*Brandimere v. SEC*, 844 F. 3d 1168 (10 Cir. 2016).

[3]*Landry v. FDIC*, 204 F. 3d 1125 (D.C. Cir. 2000).

[4]*Raymond J. Lucia Cos. Inc. v. SEC*, 2017 WL 2727019 (D.C. Cir. June 26, 2017)(*en banc*).

[5]*Cornelius Campbell Burgess v. FDIC*, No. 17-60579 (5th Cir. Sept. 7, 2017).

[6]*Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868, 880 (1991).

[7]*Go-Bart Importing Co. v. U.S.*, 282 U.S. 344, 352 (1931).

DAO PROMPTS SEC TO EXAMINE ICOS

By Craig Eastland

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Blockchain (now encapsulated within the generic retronym "distributed ledger technology," or DLT) was developed to track ownership and allow transactions in Bitcoin without resort to financial clearing organizations (such as a banks). But, because blockchain makes possible secure, trustworthy financial transactions without aid of institutional middlemen, some see DLT as a more significant technological innovation than cryptocurrency. One commentator described DLT as the most important technological advance since the Internet.

DLT evangelists have done more than unleash techno-utopian hyperbole. A Russian programmer named Vitalik Buterin created Ethereum, an open source "distributed virtual machine," essentially a DLT designed to run a variety of software applications. Buterin described Ethereum as a "Swiss-Army knife" capable of supporting a variety of cryptocurrencies rather than just one. Ethereum "miners," those contributing time or resources to the maintenance of the Ethereum machine, are compensated in Ether—Ethereum's cryptocurrency.

Ethereum's ability to run complex applications (often called "smart contracts") produced a torrent of initial coin offerings (ICOs)—a fundraising technique involving the exchange of Bitcoin or Ether for specialized cryptocurrencies, often called "tokens." Cryptofinance research group Smith & Crown identified only five ICOs in all of 2016. In August 2017 there were 130.

ICOs sold in August of 2017 range from concrete to utopian, with stops at zany and lurid. Many (39%) were parochial—aimed at developing tools, like ICO platforms, and cryptocurrency payments systems, to improve the functioning of the crypto-economy. A handful derive value from other assets, like gold or real estate, including one that performs the reverse-alchemic trick of turning money into cobalt. More ephemeral offers included a token designed to capture the value of good deeds, and one seeking to commodify time. Most of the tokens can be resold on cryptocurrency exchanges, but carry no other rights. Slightly more than half of the August ICOs identified by Smith & Crown were available to U.S. purchasers.

Although the crypto-economy remains small, this

No. 17-130

In the Supreme Court of the United States

RAYMOND J. LUCIA, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

Whether the Securities and Exchange Commission's use of administrative law judges as hearing officers in administrative proceedings violates constitutional limitations on "Officers of the United States." U.S. Const. Art. II, § 2, Cl. 2.

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-36a) is reported at 832 F.3d 277. The order of the en banc court of appeals denying the petition for review by an equally divided court (Pet. App. 1a-2a) is reported at 868 F.3d 1021. The opinion and order of the Securities and Exchange Commission (Pet. App. 37a-109a) are reported at 112 SEC Docket 1754, and are available at 2015 WL 5172953.

JURISDICTION

The judgment of the court of appeals was entered on August 9, 2016. The court granted rehearing and entered a new judgment denying the petition for review on June 26, 2017 (Pet. App. 1a-2a). The petition for a writ of certiorari was filed on July 21, 2017. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Congress has created a comprehensive scheme for the commencement, adjudication, and judicial review of proceedings brought by the Securities and Exchange Commission (SEC or Commission) to enforce the Nation's securities laws. The Commission is authorized under the Securities Act of 1933, 15 U.S.C. 77a *et seq.*, the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, and the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 *et seq.*, to address statutory violations by instituting administrative proceedings before the agency. See, *e.g.*, 15 U.S.C. 77h-1, 78u-3, 80a-9(b), 80a-41(a), 80b-3(e), (f), and (k); 15 U.S.C. 78d, 78*o* (2012 & Supp. IV 2016).

In an administrative enforcement proceeding, the Commission itself may preside and issue a final decision. 17 C.F.R. 201.110. In the alternative, Congress has authorized the Commission to delegate "its functions to a division of the Commission, an individual Commissioner, an administrative law judge, or an employee or employee board." 15 U.S.C. 78d-1(a). Exercising this authority, the Commission has provided by rule that it may delegate the initial stages of conducting an enforcement proceeding to a "hearing officer." 17 C.F.R. 201.110. The hearing officer may be an administrative law judge (ALJ), a single Commissioner, multiple Commissioners (short of a quorum of the Commission), or "any other person duly authorized to preside at a hearing." 17 C.F.R. 201.101(a)(5).

The Commission historically has chosen to assign ALJs to act as hearing officers in its proceedings. Under 5 U.S.C. 3105, "[e]ach agency shall appoint as many

administrative law judges as are necessary for proceedings required to be conducted in accordance with sections 556 and 557 of this title," which are provisions governing agency hearings where an adjudication is required by statute to be determined on the record after an opportunity for a hearing. See 5 U.S.C. 553, 556, 557. The Commission currently employs five ALJs, who are hired through a competitive examination process conducted by the Office of Personnel Management (OPM). 5 U.S.C. 1104(a)(2); 5 C.F.R. 930.201.[1] OPM scores the examinations, ranks the candidates, and prepares a list of eligible candidates. See 5 C.F.R. 332.401, 332.402. In appointing ALJs, agencies may select from a top-three list of eligible candidates provided by OPM, 5 U.S.C. 3317(a), 3318(a), or they may select an ALJ who has an existing appointment from the same or a different agency, 5 C.F.R. 2.2(a). The Commission's ALJs are selected by its Chief ALJ, subject to approval by the Commission's Office of Human Resources on the exercise of authority delegated by the Commission. Pet. App. 295a-297a; cf. 15 U.S.C. 78d(b)(1) (Commission's authority to "appoint and compensate officers, attorneys, economists, examiners, and other employees").

In the capacity of a hearing officer in an SEC enforcement proceeding, an ALJ "shall have the authority to do all things necessary and appropriate to discharge his or her duties." 17 C.F.R. 201.111. Among other responsibilities, the ALJ may administer oaths; issue, revoke, quash, or modify subpoenas; receive and rule on the admission of evidence; withhold a party's access to agency documents; and "rul[e] upon all procedural and

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[1] See U.S. OPM, *ALJs by Agency* (Mar. 2017), https://www.opm.gov/services-for-agencies/administrative-law-judges/#url=ALJs-by-Agency.

other motions." 17 C.F.R. 201.111(h); see 17 C.F.R. 201.111(a), (b), and (c), 201.230(a)(1). In response to "[c]ontemptuous conduct" during a proceeding, the ALJ may exclude the contemnor from the hearing or may "[s]ummarily suspend that person from representing others in the proceeding." 17 C.F.R. 201.180(a)(1)(ii). If the ALJ concludes that a filed document "fails to comply" with the Commission's rules or with the ALJ's own orders, the ALJ may "reject" the filing, which "shall not be part of the record." 17 C.F.R. 201.180(b). The ALJ also may, under certain circumstances, deem a party to be "in default" and thus may "determine the proceeding against that party upon consideration of the record * * * , the allegations of which may be deemed to be true." 17 C.F.R. 201.155(a).

Following an administrative hearing, the ALJ must issue an "initial decision" within a specified number of days. 17 C.F.R. 201.360(a)(2). The ALJ's initial decision may be reviewed by the Commission *sua sponte* or at the request of a party or other aggrieved person. 17 C.F.R. 201.410, 201.411(c). If further review is not requested, or if the Commission declines to undertake such review, the ALJ's initial decision "shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. 78d-1(c); see 17 C.F.R. 201.360(d)(2). When review by the Commission does occur, the Commission may "make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. 201.411(a). The Commission also may remand the case to the ALJ to take additional evidence or may itself take additional evidence. 17 C.F.R. 201.452. The Commission will either issue its own opinion or will issue a "finality order"

stating that the ALJ's initial decision has become final and effective. 17 C.F.R. 201.360(d)(2); see Pet. App. 90a.

A party who is aggrieved by a final order of the Commission may seek judicial review of that order by filing a petition for review directly in a federal court of appeals. See 15 U.S.C. 77i(a), 78y(a)(1), 80a-42(a), 80b-13(a).

2. Petitioners were registered investment advisers who marketed a wealth-management strategy, which they called "Buckets of Money," under which retirement savings were divided among assets of different risk levels (*e.g.*, bonds, fixed annuities, and stocks) and periodically reallocated as those assets changed in value. Pet. App. 38a, 41a, 127a. The Commission instituted administrative proceedings against petitioners based on allegations that petitioners had used misleading slideshow presentations to deceive prospective clients about how the Buckets of Money strategy would have performed under historical market conditions. *Id.* at 41a-51a; see *id.* at 54a-62a (describing effects of alleged misrepresentations). The Commission charged petitioners with violating the Securities Exchange Act, the Investment Advisers Act, and the Investment Company Act. *Id.* at 238a.

a. The Commission assigned the initial stages of the proceeding to an ALJ, who conducted a hearing that lasted nine days. Pet. App. 116a. The ALJ presided over witness testimony and cross-examinations, admitted documentary evidence, and ruled on objections. Pet. 5. In so doing, the ALJ established "the official record" of the administrative proceeding. Pet. App. 117a n.2.

After the hearing, the ALJ issued an initial decision finding that petitioners had made fraudulent misrepresentations related to one of their investment strategies.

Pet. App. 117a. After the Commission directed the ALJ to make additional factual findings with respect to other alleged misrepresentations, *id.* at 118a, the ALJ issued a revised initial decision finding that respondents had willfully and materially misled investors, in violation of the Investment Advisers Act, *id.* at 195a-225a. The decision ordered a variety of sanctions to be imposed on petitioners, including revocation of their registrations as investment advisers; a permanent bar on associating with investment advisers, brokers, or dealers; a cease-and-desist injunction against future violations; and a total of $300,000 in civil monetary penalties. *Id.* at 235a; see *id.* at 225a-233a.

b. On appeal, the Commission conducted "an independent review of the record, except with respect to those findings not challenged on appeal." Pet. App. 40a. The Commission determined that the ALJ had correctly found that petitioners, in marketing their Buckets of Money Strategy, had willfully made fraudulent statements and omissions in violation of the Investment Advisers Act. *Id.* at 66a-86a. The Commission also largely "affirm[ed]," with limited exceptions, "the sanctions imposed below" by the ALJ. *Id.* at 95a; see *id.* at 95a-107a. Commissioners Gallagher and Piwowar dissented with respect to one aspect of the Commission's liability determination. *Id.* at 110a-114a.

Petitioners argued before the Commission that the proceedings against them were unlawful because the ALJ who had conducted the hearing and issued the initial decision was an "Officer[] of the United States" within the meaning of the Appointments Clause, U.S. Const. Art. II, § 2, Cl. 2. See Pet. App. 86a. Petitioners noted that the ALJ had not been appointed, in accordance with that provision, "by the President, the head of

a department, or a court of law." *Id.* at 87a. The Commission rejected petitioners' argument. In the Commission's view, its ALJs were mere employees rather than constitutional officers because they do not exercise "significant authority independent of the [Commission's] supervision." *Id.* at 88a. Among other things, the Commission explained, its ALJs "issue 'initial decisions' that are * * * not final," *id.* at 88a-89a; a person aggrieved by an initial decision may seek review before the Commission, which "grant[s] virtually all petitions for review," *id.* at 89a (citation omitted); the Commission may review any ALJ decision *sua sponte*, *ibid.*; review of an ALJ's decision is *de novo*, *id.* at 90a-91a; and under the Commission's rules, "no initial decision becomes final simply on the lapse of time by operation of law," but instead becomes final only upon "the Commission's issuance of a finality order," *id.* at 90a (citation and internal quotation marks omitted). The Commission also distinguished this Court's decision in *Freytag* v. *Commissioner*, 501 U.S. 868 (1991), in which special trial judges of the Tax Court were determined to be inferior officers under the Appointments Clause. Pet. App. 92a-93a; see *id.* at 92a ("*Freytag* [is] inapposite here.").

3. On appeal of the Commission's order, a panel of the court of appeals denied the petition for review. Pet. App. 3a-36a.

The court of appeals first rejected petitioners' Appointments Clause challenge, holding that the Commission's ALJs are mere employees rather than officers under the Clause because they do not exercise "significant authority pursuant to the laws of the United States." Pet. App. 11a (quoting *Buckley* v. *Valeo*, 424 U.S. 1, 126 (1976) (per curiam)); cf. *Buckley*, 424 U.S. at 126 n.162 (employees are "lesser functionaries subordinate

to officers"). For that conclusion, the court rested on its prior decision in *Landry* v. *FDIC*, 204 F.3d 1125, 1133-1134 (D.C. Cir.), cert. denied, 531 U.S. 924 (2000), holding that ALJs of the Federal Deposit Insurance Corporation (FDIC) did not exercise significant authority because they could not issue final decisions on behalf of the agency. Pet. App. 12a. The court determined that an SEC ALJ's initial decision is similarly non-final, and it rejected petitioners' attempts to distinguish *Landry*. *Id.* at 13a-19a; see *id.* at 15a ("Until the Commission determines not to order review * * * , there is no final decision that can 'be deemed the action of the Commission.'") (quoting 15 U.S.C. 78d-1(c)). The court also rejected petitioners' argument that the SEC's ALJs "exercise greater authority than FDIC ALJs in view of differences in the scope of review of the ALJ's decisions." *Id.* at 18a. The court acknowledged that "the Commission may sometimes defer to the credibility determinations of its ALJs," but it concluded that "the Commission's scope of review is no more deferential than that of the FDIC Board." *Id.* at 18a, 19a.

The court of appeals further rejected petitioners' attempt to equate the SEC's ALJs with the special trial judges of the Tax Court who were held to be officers in *Freytag*. In the court of appeals' view, the special trial judges were distinguishable because, as "members of an Article I court," they "could exercise the judicial power of the United States" and "issue final decisions in at least some cases." Pet. App. 11a, 12a. The court of appeals also found special trial judges to be different than SEC ALJs because "the Tax Court in *Freytag* was required to defer to the special trial judge's factual and credibility findings unless they were clearly erroneous."

Id. at 19a (citation and internal quotation marks omitted). The Commission, by contrast, "is not required to adopt the credibility determinations of an ALJ." *Ibid.*

On the merits, the court of appeals determined that substantial evidence supported the Commission's finding that petitioners, acting with the requisite scienter, had made material misstatements and omissions in violation of the Investment Advisers Act. Pet. App. 21a-32a. The court also concluded that the Commission had not abused its discretion in ordering sanctions against petitioners. *Id.* at 33a-36a.

4. Petitioners sought rehearing en banc, which the court of appeals granted on February 16, 2017. Pet. App. 244a-246a. The order granting rehearing en banc vacated the panel's judgment but not its opinion. *Id.* at 245a. The order directed the parties to limit their briefs to two issues: (1) whether "the SEC administrative law judge who handled this case [was] an inferior officer rather than an employee for the purposes of the Appointments Clause"; and (2) whether the court should "overrule *Landry*." *Ibid.* On June 26, 2017, the en banc court issued a per curiam judgment denying the petition for review "by an equally divided court." *Id.* at 1a-2a.

DISCUSSION

As this Court has previously observed, the question "[w]hether administrative law judges are necessarily 'Officers of the United States' is disputed." *Free Enterprise Fund* v. *Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 507 n.10 (2010) (quoting U.S. Const. Art. II, § 2, Cl. 2). In prior stages of this case, the government argued that the Commission's ALJs are mere employees rather than "Officers" within the meaning of the Appointments Clause. Upon further consideration, and in light of the implications for the exercise of executive

power under Article II, the government is now of the view that such ALJs are officers because they exercise "significant authority pursuant to the laws of the United States." *Buckley* v. *Valeo*, 424 U.S. 1, 126 (1976) (per curiam).

This Court's review is warranted. The courts of appeals are divided over whether the Commission's ALJs are officers. That division reflects pervasive uncertainty over the scope of this Court's holding in *Freytag* v. *Commissioner*, 501 U.S. 868 (1991), the only decision of this Court since *Buckley* to address the line between employees and officers under the Appointments Clause. The question presented has arisen frequently across the courts of appeals on petitions for review of the Commission's decisions, and it will continue to arise absent this Court's intervention. The question is also extremely important because it affects not merely the Commission's enforcement of the federal securities laws, but also the conduct of adversarial administrative proceedings in other agencies within the government. The petition for a writ of certiorari therefore should be granted, and this Court should appoint an amicus curiae to defend the judgment below.

A. The Commission's ALJs Are Officers Of The United States Rather Than Employees

1. The Constitution vests "[t]he executive Power" of the United States in the President, U.S. Const. Art. II, § 1, Cl. 1, who is charged with responsibility to "take Care that the Laws be faithfully executed," *id.* § 3. The Framers, however, recognized that, "in a republican government," the President would need to rely on the assistance of subordinate officials "to give dignity, strength, purity, and energy to the administration of

the laws." 3 Joseph Story, *Commentaries on the Constitution of the United States* § 1524, at 376 (1833). The Constitution accordingly authorizes the "establish[ment] by Law" of additional executive "Offices," and provides for them to be filled by "Officers of the United States." U.S. Const. Art. II, § 2, Cls. 1, 2; see William Rawle, *A View of the Constitution of the United States of America* 151, 152 (photo. reprint 2003) (2d ed. 1829) (describing the creation of "[s]ubordinate offices" as being "[a]mong the means provided to enable the president to perform his public duties").

The Appointments Clause sets out the exclusive method for appointment of all such Executive Branch officers whose appointments are not otherwise provided for in the Constitution. "[P]rincipal Officer[s]" are appointed by the President, by and with the advice and consent of the Senate; the same method applies to "inferior Officers," except where their appointments have instead been vested by law "in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. Const. Art. II, § 2, Cls. 1, 2; see *United States* v. *Germaine*, 99 U.S. 508, 510 (1879) ("[A]ll persons who can be said to hold an office under the government about to be established under the Constitution were intended to be included within one or the other of these modes of appointment."). The requirements of the Appointments Clause are "among the significant structural safeguards of the constitutional scheme" and are "designed to preserve political accountability relative to important Government assignments." *Edmond* v. *United States*, 520 U.S. 651, 659, 663 (1997).

In *Buckley*, *supra*, the Court explained that "the term 'Officers of the United States' as used in Art. II"

includes all those who hold a position "under the government" and "exercis[e] significant authority pursuant to the laws of the United States." 424 U.S. at 125-126 (citations and internal quotation marks omitted). That description reflects the common understanding at the time of the Founding that "[a] public office is the right, authority and duty, created and conferred by law, by which for a given period * * * an individual is invested with some portion of the sovereign functions of government, to be exercised by him for the benefit of the public." Floyd R. Mechem, *A Treatise on the Law of Public Offices and Officers* § 1, at 1-2 (1890) (summarizing English and early American sources); see 2 Giles Jacob, *The Law-Dictionary*, Tit. "Office" (1797) ("[I]t is a rule, that where one man hath to do with another's affairs against his will, and without his leave, that this is an Office, and he who is in it is an officer."); see also 20 Op. O.L.C. 124, 178-187 (1996).[2]

2. Since *Buckley*, this Court has only once addressed the line between constitutional officers and

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[2] Early decisions of this Court addressing the Appointments Clause were primarily concerned with the question whether Congress *intended* to treat a position it had created by statute as an "office," not whether the functions of the position were required to be performed by an officer appointed pursuant to the Appointments Clause. See, *e.g.*, *Germaine*, 99 U.S. at 509 (civil surgeon could not be prosecuted under criminal statute applicable only to an "officer of the United States who is guilty of extortion") (citation omitted); *United States* v. *Hartwell*, 73 U.S. (6 Wall.) 385, 391-392 (1867) (statute forbidding embezzlement by "officers" applied to clerk appointed by the assistant treasurer in Boston with the approbation of the Acting Secretary of the Treasury) (discussed in *Germaine*, 99 U.S. at 511). In those cases, the Court looked at whether the appointment had occurred in the manner contemplated by the Clause as evidence for whether Congress intended to treat the appointee as an officer.

mere employees. In *Freytag*, *supra*, the Court considered whether certain Tax Court proceedings could be assigned, "for [a] hearing and the preparation of proposed findings and written opinion," to a special trial judge appointed by the Chief Judge of the Tax Court. 501 U.S. at 877. The petitioners in *Freytag* were taxpayers who had objected to tax deficiencies assessed against them and sought review in the Tax Court. *Id.* at 870-871. The proceedings were initially assigned to a special trial judge, who issued "written findings and an opinion" concluding that the petitioners owed additional taxes. *Id.* at 871-872. After unsuccessfully appealing that ruling to the Chief Judge, the petitioners "contended that the assignment of cases as complex as theirs to a special trial judge * * * violated the Appointments Clause of the Constitution." *Id.* at 872.

In addressing that claim, this Court at the outset considered whether "special trial judges may be deemed employees * * * because they lack authority to enter a final decision." *Freytag*, 501 U.S. at 881. That argument, the Court explained, "ignores the significance of the duties and discretion that special trial judges possess." *Ibid.* Unlike special masters, who are hired "on a temporary, episodic basis" to perform ad hoc tasks, special trial judges occupy an office "'established by Law,'" and the "duties, salary, and means of appointment for that office are specified by statute." *Ibid.* (quoting U.S. Const. Art. II, § 2, Cl. 2). The Court placed particular emphasis on the fact that special trial judges, in presiding over preliminary proceedings, "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders." *Id.* at 881-882. "In the course of car-

rying out these important functions," the Court explained, "special trial judges exercise significant discretion." *Id.* at 882.

The Court went on to hold that special trial judges would qualify as constitutional officers "[e]ven if" their ability to issue initial decisions in cases like petitioners' were not so "significant." *Freytag*, 501 U.S. at 882; *ibid.* ("[O]ur conclusion would be unchanged."). That is because, the Court explained, special trial judges are also authorized by law to "render the decisions of the Tax Court [*i.e.*, final decisions] in declaratory judgment proceedings and limited-amount tax cases." *Ibid.* Since it was not disputed that "a special trial judge is an inferior officer for purposes of" those proceedings, the Court concluded, their appointments must comply with the Appointments Clause for all purposes. *Ibid.* ("Special trial judges are not inferior officers for purposes of some of their duties * * * but mere employees with respect to other responsibilities."). Finally, having determined that the Appointments Clause applied to special trial judges, the Court held that their selection could properly be vested under that Clause in the Chief Judge of the Tax Court. *Id.* at 882-892.

Freytag demonstrates that the Commission's ALJs are "inferior officers" rather than "mere employees." 501 U.S. at 882. Like the special trial judges at issue there, the office of an SEC ALJ is characterized by significant "duties and discretion." *Id.* at 881. The position and its compensation have been established by law, see 5 U.S.C. 3105 (appointment authority), 5372(b) (compensation), and the Commission's ALJs have been entrusted with governmental authority "delegate[d]" from the Commission itself, 15 U.S.C. 78d-1(a). ALJs are authorized, among other things, to administer

oaths, hold hearings, take testimony and admit evidence, issue or quash subpoenas, rule on motions, impose sanctions on contemptuous hearing participants, reject deficient filings, and enter default judgments. See 17 C.F.R. 201.111(a), (b), (c), and (h), 201.180(a) and (b).[3] At the conclusion of a hearing, the ALJ issues an "initial decision" that "include[s] findings and conclusions * * * as to all the material issues of fact, law or discretion presented on the record and the appropriate order, sanction, relief, or denial thereof." 17 C.F.R. 201.360(b). If further review of the ALJ's decision is not sought, or a request for such review is denied by the Commission, the ALJ's initial decision "shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. 78d-1(c); see 17 C.F.R. 201.360(d)(2). In discharging these responsibilities, an ALJ "exercise[s] significant discretion." *Freytag*, 501 U.S. at 881-882. The ALJ is thus an "Officer[]" within the meaning of the Appointments Clause.

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[3] The special trial judges at issue in *Freytag* were authorized to "punish contempts by fine or imprisonment." 501 U.S. at 891 (citing 26 U.S.C. 7456(c)). The Commission's ALJs, by contrast, have the arguably less significant authority to punish "[c]ontemptuous conduct" either by "[e]xclud[ing]" the contemnor from the deposition or hearing or by "[s]ummarily suspend[ing] that person from representing others in the proceeding." 17 C.F.R. 201.180(a)(1). The Court's decision in *Freytag*, however, did not identify the power to fine or imprison as evidence of "the significance of the duties and discretion that special trial judges possess." 501 U.S. at 881. Rather, the contempt power was cited only as support for the Court's conclusion that the Tax Court was a "'Court of Law' within the meaning of the Appointments Clause." *Id.* at 890 (brackets omitted); see *id.* at 890-891.

3. In ruling that the Commission's ALJs are not officers, the court of appeals gave dispositive weight to its perception that those ALJs have no authority to issue final decisions that "bind third parties, or the government itself, for the public benefit." Pet. App. 12a-13a; see *id.* at 13a ("Our analysis begins, and ends, there."). The court relied for that conclusion on its prior decision in *Landry* v. *FDIC*, 204 F.3d 1125 (D.C. Cir.), cert. denied, 531 U.S. 924 (2000), where the court read *Freytag* as treating final decision-making authority as the *sine qua non* of officer status. Pet. App. 11a-13a; see *id.* at 12a ("This court understood that it 'was critical to the Court's decision' in *Freytag* that the special trial judge had authority to issue final decisions in at least some cases.") (quoting *Landry*, 204 F.3d at 1134). The Commission's ALJs, the court of appeals asserted, cannot issue final decisions: An ALJ's initial decision "becomes final when, and only when, the Commission issues [a] finality order, and not before then." *Id.* at 15a; see *ibid.* ("[T]he Commission has retained full decision-making powers, and the mere passage of time is not enough to establish finality."). As a result, the court concluded, the "initial decisions are no more final than the recommended decisions issued by FDIC ALJs" that the court had upheld in *Landry*. *Id.* at 17a.

As petitioners here explain (Pet. 20-22), however, the court of appeals erred in placing conclusive weight on the lack of final decision-making authority by the Commission's ALJs. Although *Landry* treated that factor as "critical," 204 F.3d at 1134, *Freytag* held that special trial judges—in light of "the significance of the duties and discretion that [they] possess"—are properly considered officers under the Appointments Clause *despite*

their "lack [of] authority to enter a final decision" regarding tax-deficiency claims. 501 U.S. at 881. To be sure, the Court went on to say that special trial judges would be officers "[e]ven if" their authority over such cases were less "significant," given their authority to render final decisions in other types of cases. *Id.* at 882. But "the Court clearly designated [that statement] as an alternative holding." *Landry*, 204 F.3d at 1142 (Randolph, J., concurring in part and concurring in the judgment). The Court in *Freytag* thus indicated that final authority to make certain discretionary decisions may be sufficient, but is not necessary, to render an official an "Officer[] of the United States" within the meaning of the Appointments Clause.

In attempting to distinguish *Freytag*, the court of appeals further emphasized the relatively low level of deference afforded by the Commission to ALJ decisions. The Commission "reviews an ALJ's decision *de novo* and 'may affirm, reverse, modify, or set aside' the initial decision, 'in whole or in part,' and it 'may make any findings or conclusions that in its judgment are proper and on the basis of the record.'" Pet. App. 18a-19a (quoting 17 C.F.R. 201.411(a)) (brackets omitted). And while the Commission has chosen, as a matter of practice, to "defer to credibility determinations where the record provides no basis for disturbing the finding," the Commission is "not required to adopt the credibility determinations of an ALJ." *Id.* at 19a. By contrast, the court of appeals emphasized, "the Tax Court in *Freytag* was required to defer to the special trial judge's factual and credibility findings unless they were clearly erroneous." *Ibid.* (citation and internal quotation marks omitted).

The court of appeals' proposed distinction from *Freytag* is not persuasive. The level of deference afforded to the decisions of special trial judges played no role in the Court's conclusion that they qualified as "Officers" within the meaning of the Appointments Clause. See 501 U.S. at 880-882. The Court mentioned deference in a different portion of *Freytag* addressing the petitioners' statutory-construction argument, and even there the Court stated that the "point [wa]s not relevant." *Id.* at 874 n.3. Nor, in this case, does the Commission's relative lack of deference to the decisions of its ALJs call into question that such ALJs are "Officers of the United States" under the Appointments Clause. Finally, there is no merit to the court of appeals' attempt to distinguish *Freytag* on the ground that special trial judges were "members of an Article I court [who] could exercise the judicial power of the United States." Pet. App. 11a. In determining that the special trial judges were officers, *Freytag* did not even mention their status as judicial officials.

B. The ALJs' Status As Officers Has Implications For Both Their Selection And Removal That The Court Should Address

The conclusion that ALJs are "Officers of the United States" has important implications under the Constitution regarding the permissible method of their appointment and the manner in which they may be removed from office. This Court's guidance on both issues is accordingly necessary to enable the United States to assess the status of ALJs in various roles across the government and to consider whether the rules governing the selection and removal of those officials comport with constitutional requirements.

1. Under the Appointments Clause, Congress may "vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. Const. Art. II, § 2, Cl. 2. The appointment of the ALJ who presided in petitioners' case did not conform to that command. That ALJ was selected by the Commission's Chief ALJ, subject to approval by the Commission's Office of Human Resources. See pp. 2-3, *supra*. The Commission itself, as the constitutional "Head[] of Department[]," did not play any role in the selection. See Pet. App. 295a-297a.

2. Because "Article II confers on the President 'the general administrative control of those executing the laws,' * * * the President therefore must have some 'power of removing those for whom he can not continue to be responsible.'" *Free Enterprise Fund*, 561 U.S. at 492-493 (quoting *Myers* v. *United States*, 272 U.S. 52, 117, 164 (1926)). This Court has accordingly recognized that the Constitution forbids Congress from placing certain restrictions on the power to remove officers of the United States. In *Free Enterprise Fund*, the Court invalidated a statutory scheme that provided for two levels of protection against presidential removal authority: Members of the Public Company Accounting Oversight Board (PCAOB) could be removed by the SEC only for certain limited forms of wrongdoing, see 15 U.S.C. 7217(d)(3), and the Court assumed that the SEC's Commissioners could themselves be removed only for "inefficiency, neglect of duty, or malfeasance in office," 561 U.S. at 487 (citation omitted). The Court determined that the combined effect of those restrictions, which resulted in the PCAOB's exercise of executive authority without any meaningful presidential oversight,

had caused a constitutionally impermissible "diffusion of accountability." *Id.* at 497; see *id.* at 495-508.

Here, the statutory scheme provides for at least two, and potentially three, levels of protection against presidential removal authority: The Commission's ALJs may be removed by the Commission "only for good cause established and determined by the Merit Systems Protection Board," 5 U.S.C. 7521(a), and members of that Board in turn "may be removed by the President only for inefficiency, neglect of duty, or malfeasance in office," 5 U.S.C. 1202(d). And the Commissioners likewise may be insulated from removal (as the Court assumed in *Free Enterprise Fund*), although the Securities Exchange Act is silent on the question. 15 U.S.C. 78d(a). Under *Free Enterprise Fund* and other decisions, the status of the Commission's ALJs as constitutional "Officers" therefore has implications for whether the statutory restrictions on their removal are consistent with separation-of-powers principles.

Petitioners assert (Pet. 34) that the issue of removal authority should be of no immediate concern to the Court because they have not directly challenged the removal restrictions on the ALJ who presided at their hearing. But petitioners do not dispute that the question whether the Commission's ALJs are impermissibly insulated from presidential oversight is informed by the conclusion that such ALJs are constitutional officers who exercise significant authority. See *Free Enterprise Fund*, 561 U.S. at 507 n.10 (reserving the question, in part, because "[w]hether administrative law judges are necessarily 'Officers of the United States' is disputed") (citing *Landry*, *supra*). And even if petitioners are successful in obtaining invalidation of the proceedings against them in this case, and further proceedings occur

in front of a properly appointed ALJ, the removal question would continue to cloud the ALJ's authority. Indeed, another litigant has already raised a separation-of-powers challenge to ALJ removal protections alongside an Appointments Clause challenge; that case has been briefed in the D.C. Circuit and is being held pending the disposition of this petition. See 8/8/17 Order, *Timbervest* v. *SEC*, No. 15-1416.

It is critically important that the Court, in considering whether the Commission's ALJs are "Officers of the United States," address whether the restrictions imposed by statute on their removal are consistent with the constitutionally prescribed separation of powers. Addressing that issue now will avoid needlessly prolonging the period of uncertainty and turmoil caused by litigation of these issues. See pp. 24-26, *infra*. If the Court believes that petitioners' framing of the question presented is not broad enough to encompass the issue, the government has reframed the question to leave no doubt on that score. In the alternative, the Court may find it desirable to add a question presented that specifically addresses it. See, *e.g.*, *NLRB* v. *Noel Canning*, 133 S. Ct. 2861 (2013) (directing the parties to brief and argue an additional question, which had not been considered by the courts below). Whatever the appropriate course, the government respectfully submits that addressing both the appointment and removal of the Commission's ALJs will provide needed clarity to agencies and regulated parties, while minimizing what could otherwise be severe disruption to a large number of current and future administrative proceedings.

C. This Case Is The Preferable Vehicle For Resolving The Division Among The Courts Of Appeals

This Court's review is warranted because the question presented has led to significant disagreement in the courts of appeals. That disagreement has generated substantial confusion and disruption for the Commission in its enforcement of the Nation's securities laws, as well as for other federal agencies that use ALJs in administrative proceedings.

1. In the proceeding below, a panel of the D.C. Circuit held that the Commission's ALJs are employees rather than officers. The court subsequently granted rehearing en banc, Pet. App. 244a-246a, and ultimately denied the petition for review by an equally divided vote, *id.* at 1a-2a. Under D.C. Circuit Rule 35(d), an order granting en banc review vacates "the panel's judgment, but ordinarily not its opinion." Consistent with that rule, the court's order granting rehearing en banc vacated only the panel's "judgment," 2/16/17 Order 1, leaving the panel's opinion undisturbed.

The Commission has therefore explained, in other cases raising Appointments Clause challenges, that the panel's opinion in this case remains in effect. See, *e.g.*, Commission Br. at 62, *Gonnella* v. *SEC*, No. 16-3433 (2d Cir. July 17, 2017). The Commission has also urged the D.C. Circuit to hold follow-on cases raising the same question in abeyance pending this Court's disposition of the petition for a writ of certiorari. See, *e.g.*, Mot. to Hold Case in Abeyance, *Timbervest, LLC* v. *SEC*, No. 15-1416 (July 20, 2017). The D.C. Circuit has granted those abeyance motions. See, *e.g.*, 8/8/17 Order, *Timbervest, LLC* v. *SEC*, No. 15-1416.

2. In *Bandimere* v. *SEC*, 844 F.3d 1168 (2016), a divided panel of the Tenth Circuit reached the opposite

conclusion on the question presented under materially identical circumstances. There, an ALJ issued an initial decision finding that the respondent had violated antifraud and registration provisions of the federal securities laws by operating as an unregistered broker and by failing to disclose potentially negative facts to investors. *In re David F. Bandimere*, Securities Act Release No. 9972, 2015 WL 6575665, at *1 (Oct. 29, 2015). On review of the ALJ's initial decision, the Commission upheld the liability finding and imposed disgorgement and civil-penalty sanctions. *Id.* at *2. The Commission also rejected the respondent's argument that its ALJs are officers under the Appointments Clause. *Id.* at *19-*21.

The Tenth Circuit granted the respondent's petition for review, holding that the Commission's ALJs are invested with powers that require their appointment as inferior officers under the Appointments Clause. *Bandimere*, 844 F.3d at 1179-1182. In reaching that conclusion, the court relied on *Freytag*, which it interpreted as turning on the significance of the special trial judges' duties, not on their authority to render final decisions of the Tax Court. *Id.* at 1182-1185; see *id.* at 1179 (The Commission's ALJs "exercise significant discretion in performing 'important functions' commensurate with the [special trial judges'] functions described in *Freytag*.") (quoting 501 U.S. at 882). The court thus expressly "disagree[d]" with the D.C. Circuit's decisions in *Landry* and in this case, which, the Tenth Circuit determined, had "place[d] undue weight on final decision-making authority." *Id.* at 1182.

Judge McKay dissented, arguing that *Freytag* does not "mandate[] the result proposed here." *Bandimere*, 844 F.3d at 1194. Like the panel in this case, Judge

McKay distinguished the special trial judges at issue in *Freytag* because of their authority to enter final decisions in a number of cases and because "the Tax Court was required to defer to its special trial judges' findings." *Id.* at 1197. Judge McKay emphasized that the Commission's ALJs, by contrast, "possess only a 'purely recommendatory power.'" *Ibid.* (quoting *Landry*, 204 F.3d at 1132). In May 2017, the Tenth Circuit denied the Commission's petition for rehearing en banc, with Judges Lucero and Moritz dissenting. See *Bandimere* v. *SEC*, 855 F.3d 1128, 1128-1133.

On September 29, 2017, the government filed a petition for a writ of certiorari in *SEC* v. *Bandimere*, No. 17-475, urging this Court to resolve the question whether the Commission's ALJs are inferior officers rather than employees. But the government explained that this case, rather than *Bandimere*, presents the Court with the preferable vehicle for addressing that question. See Pet. at 9, *Bandimere*, *supra* (No. 17-475). The government accordingly "respectfully request[ed] that the Court hold th[e] petition" in *Bandimere* "pending its consideration of the petition" in this case. *Ibid.*

3. The disagreement in the courts of appeals has significant implications for the Commission's ability to discharge its statutory responsibilities. Congress has granted the Commission broad authority to conduct administrative enforcement proceedings to determine whether the securities laws have been violated and, if so, what remedies are appropriate. See 15 U.S.C. 77h-1, 78u-3; 15 U.S.C. 78d, 78*o* (2012 & Supp. IV 2016). Certain of the Commission's enforcement powers, such as the power to revoke the registration of a registered security under 15 U.S.C. 78*l*(j), can be exercised *only* through the initiation of an administrative proceeding.

In conducting such proceedings, the Commission historically has assigned an ALJ to preside over the hearing and issue an initial decision, which the Commission then reviews. See 15 U.S.C. 78d-1(a). The abeyance status of cases pending in the D.C. Circuit—which has automatic venue in securities cases, see 15 U.S.C. 77i(a), 78y(a)(1), 80a-42(a), 80b-13(a)—thus means that the Commission's ability to enforce the nation's securities laws has, in significant respects, been put on hold pending this Court's resolution of the question presented. Appointments Clause challenges to the Commission's ALJs have also been raised in several other cases across the courts of appeals, indicating that the gridlock will soon be even more widespread.[4]

4. Finally, the conflict in the courts of appeals on the question presented has created substantial uncertainty for other agencies that employ ALJs in a manner similar to the Commission. A panel of the Fifth Circuit recently granted a stay of an FDIC order, concluding that the respondent had established a likelihood of success on his claim that the ALJ who presided over his proceeding was an officer who was not properly appointed under the Appointments Clause. *Burgess* v. *FDIC*, 871 F.3d 297 (2017). In so ruling, the court expressly disagreed with the D.C. Circuit's decision in *Landry*. *Id.* at 301 ("We therefore conclude, contrary to the D.C. Circuit's decision in *Landry*, that final decision-making authority is not a necessary condition for Officer sta-

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[4] See, *e.g.*, *Gonnella* v. *SEC*, No. 16-3433 (2d Cir. filed Oct. 7, 2016); *Bennett* v. *SEC*, No. 16-3827 (8th Cir. argued June 7, 2017); *J.S. Oliver Capital Mgmt., L.P.* v. *SEC*, No. 16-72703 (9th Cir. filed Aug. 15, 2016); *Feathers* v. *SEC*, No. 15-70102 (9th Cir. filed Jan. 9, 2015).

tus."). Given the frequency with which ALJs are employed in administrative proceedings by a variety of federal agencies, see, *e.g.*, 7 C.F.R. 1.144, 1.411(f) (Department of Agriculture); 12 C.F.R. 1081.103 (Consumer Financial Protection Bureau); 18 C.F.R. 385.102(e), 385.708 (Federal Energy Regulatory Commission); 29 C.F.R. 102.35 (National Labor Relations Board); 40 C.F.R. 22.3(a), 22.4(c) (Environmental Protection Agency), this Court's resolution of the question presented is necessary to prevent the same disruption that has affected the Commission's proceedings from spreading throughout the government.

CONCLUSION

The petition for a writ of certiorari should be granted. If appropriate, the Court should reframe the question presented or add a question presented to address the issue of removal.

Respectfully submitted.

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NOVEMBER 2017

Press Release

SEC Ratifies Appointment of Administrative Law Judges

FOR IMMEDIATE RELEASE
2017-215

Washington D.C., Nov. 30, 2017 — The Securities and Exchange Commission today announced that it has ratified its prior appointment of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil.

On Nov. 29, 2017, the Office of Solicitor General submitted a brief in the Supreme Court in *Raymond J. Lucia and Raymond J. Lucia Companies Inc. v. Securities and Exchange Commission* (No. 17-130) asking the Court to decide whether the Commission's ALJs are inferior officers who must be appointed consistent with the Appointments Clause of the Constitution. The Solicitor General's brief takes the position that the Commission's ALJs are inferior officers. By ratifying the appointment of its ALJs, the Commission has resolved any concerns that administrative proceedings presided over by its ALJs violate the Appointments Clause. The Commission Order also directs the ALJs to review their actions in all open administrative proceedings to determine whether to ratify those actions.

SEC Order: https://www.sec.gov/litigation/opinions/2017/33-10440.pdf

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Related Materials

- SEC Order

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10440 / November 30, 2017

SECURITIES EXCHANGE ACT OF 1934
Release No. 82178 / November 30, 2017

INVESTMENT ADVISERS ACT OF 1940
Release No. 4816 / November 30, 2017

INVESTMENT COMPANY ACT OF 1940
Release No. 32929 / November 30, 2017

In re: Pending Administrative Proceedings	ORDER

On November 29, 2017, the Solicitor General on behalf of the United States submitted a brief in *Raymond J. Lucia and Raymond J. Lucia Companies, Inc. v. Securities and Exchange Commission* (No. 17-130) in which the Solicitor General agreed with the petitioners that the U.S. Supreme Court should decide whether administrative law judges of the Commission are inferior officers under the Appointments Clause, U.S. Const. Art. II, § 2, cl. 2. The Solicitor General took the position that Commission administrative law judges are inferior officers for purposes of the Appointments Clause but recommended that the Supreme Court appoint an amicus curiae to defend the contrary judgment of the Court of Appeals for the District of Columbia Circuit.

To put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause, the Commission—in its capacity as head of a department—hereby ratifies the agency's prior appointment of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil.

In addition, the Commission orders all administrative law judges presiding over pending proceedings for which no initial decision has yet been issued to undertake the following actions in each of those proceedings:

- Reconsider the record, including all substantive and procedural actions taken by an administrative law judge pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111;

- Issue an order granting parties until January 5, 2018 to submit any new evidence the parties deem relevant to the administrative law judge's reexamination of the record;

- Determine, based on such reconsideration, whether to ratify or revise in any respect all prior actions taken by an administrative law judge in the proceeding; and

- Issue an order by February 16, 2018 stating that the administrative law judge has completed the reconsideration ordered above and setting forth a determination regarding ratification.

The Commission hereby tolls the time periods in Rule of Practice 360(a) until the administrative law judge issues the order on ratification. The administrative law judges are directed to notify the parties in the cases pending before them of this order.

In matters pending before the Commission in which an administrative law judge has issued an initial decision, the Commission hereby remands any such matter to the administrative law judge who issued the initial decision. A list of matters is attached as Exhibit A to this Order. The administrative law judge is ordered to undertake the following actions in each of those proceedings:

- Reconsider the record, including all substantive and procedural actions taken by an administrative law judge pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111;

- Issue an order granting parties until January 5, 2018 to submit any new evidence the parties deem relevant to the administrative law judge's reexamination of the record;

- Determine, based on such reconsideration, whether to ratify or revise in any respect all prior actions taken by an administrative law judge in the proceeding; and

- Issue an order by February 16, 2018 stating that the administrative law judge has completed the reconsideration ordered above and setting forth the determination regarding ratification.

The administrative law judge may, for good cause shown, modify any of these deadlines, including the date by which the administrative law judge's order on ratification is to be issued.

Finally, we note that on May 22, 2017, in light of *Bandimere v. SEC*,[1] which held that the Commission's administrative law judges are inferior officers who must be appointed in a manner consistent with the Appointments Clause, U.S. Const. Art. II, § 2, cl. 2, we stayed: (1) all administrative proceedings assigned to an administrative law judge in which a respondent has the option to seek review in the Tenth Circuit of a final order of the Commission under Section 9(a) of the Securities Act, Section 25(a) of the Securities Exchange Act, Section 43(a) of the Investment Company Act, or Section 213(a) of the Investment Advisers Act; and (2) all administrative proceedings pending before the Commission on review from an initial decision by an administrative law judge in which a respondent has the option to seek review in the Tenth

[1] 844 F.3d 1168 (10th Cir. 2016), *reh'g denied*, 2017 WL 1717498 (May 3, 2017) (10th Cir. No. 15-9586), *petition for cert. pending* (No. 17-475).

Circuit of a final order of the Commission under these same statutory provisions. Having now ratified the appointment of the Commission's administrative law judges, thereby resolving any Appointments Clause claims that may have arisen in the aforementioned cases under *Bandimere*, we hereby lift the stays imposed by our May 22, 2017 order and direct that those proceedings should resume pursuant to our above instructions.

By the Commission.

Brent J. Fields
Secretary

Exhibit A

A.C. Simmonds, et al., File No. 3-17999
Accelerated Aquisition XVII, et al., File No. 3-18146
Aervision Holdings, Inc., et al., File No. 3-18199
AFN, Inc., et al., File No. 3-17743
Alexandre S. Clug, File No. 3-16318
Altovida Inc., et al., File No. 3-18104
American Magna Corp., et al., File No. 3-18105
American-Swiss Capital, Inc., et al., File No. 3-18156
ARX Gold Corporation, File No. 3-18185
Atomic Paintball, Inc., et al., File No. 3-17991
Aurios, Inc., et al., File No. 3-18092
Axesstel, Inc., File No. 3-17941
Axiom Oil & Gas Corp., et al., File No. 3-18096
Balqon Corporation, et al., File No. 3-18095
Barbara Duka, File No. 3-16349
Bioelectronics Corp., File No. 3-17104
BioPharma Manufacturing Solutions Inc., et al., File No. 3-18148
Biovest International, Inc., et al., File No. 3-17935
Bluforest, Inc., File No. 3-17558
Bohai Pharmaceuticals Group Inc., File No. 3-18151
BOLDFACE Group, Inc., et al., File No. 3-18103
Brian Michael Berger, File No. 3-18129
Canso Enterprises Ltd., et al., File Nos. 3-17984, 17989, 17985, 17986, 17987, 17988, 17989
CellCyte Genetics Corp., File No. 3-18141
Century Acquisition Corp. and Eastern Acquisition Corp., File No. 3-18162
Chile Mining Technologies Inc., File No. 3-18174
China Du Kang Co., Ltd., File No. 3-18106
China Fruits Corp. and SkyStar Bio-Pharmaceutical Co., File No. 3-18017
China Greenstar Corporation, et al., File No. 3-18097
China Hefeng Rescue Equipment, Inc., et al., File No. 3-18179
Christopher M. Gibson, File No. 3-17184
Cibolan Gold Corporation, File No. 3-18077
Circle Star Energy Corp. and Energy Holdings International, Inc., File No. 3-18142
CNK Global, Inc. (a/k/a American Life Holding Co., Inc.), File No. 3-18082
Cono Italiano, Inc., et al., File No. 3-18177
Core Resource Management, Inc., et al., File No. 3-18079
Creator Capital Ltd., File No. 3-18189
Dearborn Bancorp, Inc., File No. 18223
dELiA*s Inc. and Global Energy, Inc., File No. 3-18037
Diane Dalmy, File No. 3-16339
Digital Brand Media & Marketing Group, Inc., File No. 3-17990
Edward M. Daspin, File No. 3-16509
Energy Edge Technologies Corp. and Focus Gold Corp., File No. 3-18038
Engage Eco Solutions, Inc., et al., File No. 3-18191

Evolucia, Inc. and OSL Holdings, Inc., File No. 3-18014
E-Waste Systems, Inc., File No. 3-18107
Frank Chiappone, et al., File No. 3-15514
Fu Lu Cai Productions Ltd. and Heavy Earth Resources, Inc., File No. 3-18173
Gamzio Mobile, Inc., File No. 3-18170
GC China Turbine Corp., File No. 3-16604
Geoglobal Resources, Inc. and USA Synthetic Fuel Corp., File No. 3-18153
GL Capital Partners, LLC and GL Investment Services, LLC, File No. 3-17818 and 17819
GO EZ Corporation, et al., File No. 3-18204
GS Enviroservices, Inc., et al., File No. 3-17977
Guardian 8 Holdings, et al., File No. 3-18221
Hall Tees, Inc., et al., File No. 3-18155
Hampshire Group, Limited, File No. 3-18201
Hydrogen Future Corporation, et al., File No. 3-18220
HydroPhi Technologies Group, Inc., et al., File No. 3-18208
Ibex Advanced Mortgage Technology, Inc., File No. 3-18047
Icon Vapor, Inc., et al., File No. 3-18210
IMK GROUP, INC., et al., File No. 3-18203
Immunoclin Corp. et al., File No. 3-18190
Infinity Real Estate Holdings Corporation, et al., File No. 3-18217
Intellicell Biosciences, Inc., File No. 3-17990
James A. Winkelmann, File No. 3-17253
James E. Cohen and Joseph A. Corazzi, File No. 3-15974
James P. Griffin, File No. 3-17848
Jeffrey Gainer, File No. 3-18130
Joe Lawler, File No. 3-17650
John Austin Gibson, Jr., File No. 3-17856
John Thomas Capital Management, L.P., File No. 3-15255
Joseph J. Fox, File No. 3-16795
JuQun, Inc., et al., File No. 3-18193
KollagenX Corp., et al., File No. 3-18207
Kun De International Holdings, Inc., and Sutor Technology Group Limited, File No. 3-18169
Kung Fu Dragon Group Limited, File No. 3-18091
Laurie Bebo, File No. 3-16293
Louis V. Schooler, File No. 3-17115
Mackenzie Taylor Minerals, Inc., et al., File No. 3-18149
Medicus Homecare Inc., File No. 3-18081
Michelle L. Helterbran Cochran, CPA, File No. 3-17228
Montalvo Spirits, Inc., et al., File No. 3-18078
Neurologix, Inc., et al., File No. 3-18180
New Media Insight Group, Inc. and Pacific Sands, Inc., et al., File No. 3-18206
New Western Energy Corp. and Primco Management, Inc., File No. 3-18007
New York Sub Co., File No. 3-18038
Next Galaxy Corp. and Novamex Energy, Inc., File No. 3-18219
Paul Edward ("Ed") Lloyd, Jr., CPA, File No. 3-16182

Penny Auction Solutions, Inc., et al., File No. 3-18202
Roy Dekel, File No. 3-17751
Saving2Retire, LLC and Marian P. Young, File No. 3-17352
Sean P. Finn and M. Dwyer LLC, File No. 3-17693
Shervin Neman and Neman Financial, Inc., File No. 3-17699
SIFMA, File No. 3-15350
Spring Hill Capital Markets, LLC, et al. File No. 3-16353
StationDigital Corp., File No. 3-18004
Talman Harris and Victor Alfaya, File No. 3-17874
Tintic Gold Mining Company, File No. 3-18157
Timothy W. Carnahan, File No. 3-16386
Tod A. Ditommaso, File No. 3-17550
Vortronnix Technologies, Inc., File No. 3-18023
Warren D. Nadel, File No. 3-17883
William D. Bucci, File No. 3-17888

The *Martoma* Insider Trading Decision – Business, Gifts and Friends

Posted on September 05, 2017 by T. Gorman

The Second Circuit split over the question of gift giving in insider trading cases, upholding the conviction of former SAC Capital healthcare stock analyst Mathew Martoma. The decision is the first circuit court case to interpret the question in the wake of the Supreme Court's decision in*Salman v. U.S.,* 137 S. Ct. 420 (2016) last term. *U.S. v. Matoma,* Docket No. 14-3599 (2nd Cir. August23, 2017).

The focus of the decision is the Second Circuit's prior holding in *U.S. v. Newman,* 773, F. 3d 438 (2nd Cir. 2014). There the circuit court held that under *Dirks v. SEC,* 463 U.S. 646(1983) to impose liability in view of the theory of gift giving there mus be "proof of a meaningfully close personal relationship [between the tipper and tippee] that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." While both the majority and dissent agreed that the second prong of this test – the pecuniary gain requirement – was rejected by *Salman,* the majority concluded that "the logic of *Salman* abrogated the first *Newman* prong of the test — the 'meaningfully close personal relationship'" test. The dissent disagreed.

Background

The case centers on trades in the securities of Elan Corporation, plc and Wyeth in 2008. The two pharmaceutical companies had a significant new drug under development that had been in trials since 2006.

During the trials, Dr. Sidney Gilman, University of Michigan, was consultant to Elan. He also worked for, and was paid by, an expert network through which he met Mr. Martoma, at the time a portfolio manager at SAC Capital. Over a period of time Dr. Gilman provided Mr. Martoma with numerous briefings on the development of the drug which include confidential information. Mr. Martoma also met with Dr. Joel Ross, one of the principal investigators on the clinical trial. Dr. Ross provided Mr. Martoma with information about the trial.

On June 17, 2008 Elan and Wyeth jointly released top-line results of the Phase II trial for the drug. The announcement described the preliminary results as "encouraging" with clinically meaningful benefits in important subgroups. The release also stated that detailed results would be released on July 29, 2008. The market reacted positively to the release.

Dr. Gilman was selected in mid-July to present the results at a conference scheduled for July 29, 2008. At that point the firms shared the testresults with Dr. Gilman. The day after the Doctor learned the final test results he spoke with Mr. Martoma for about 90 minutes on the telephone. Two days later the two men met at the Doctor's office at the University of Michigan. Dr. Gilman showed the power point presentation he planned to use at the upcoming meeting to Mr. Martoma. It detailed the results.

The next morning Mr. Martoma spoke on the telephone with Stephen Cohen. SAC began to reduce its position in Elan and Wyeth securities by entering into short sale and options trades that would be profitable if the two stocks dropped in price the day after the telephone call.

Following the July 29, 2008 presentation by Dr. Gilman, the shares of both firms declined significantly. The trades that Mr. Martoma and SAC made in advance of the announcement resulted in about $80.3 million in gains and $194.6 million in avoided losses for the firm. Mr. Martoma personally received a $9 million bonus based in large part on the trading in Elan and Wyeth. While SAC had been billed substantial fees for the earlier meetings with Dr. Gilman, it had not charged for the last two discussions.

Following a jury trial the court instructed the jury on the requirements of a personal benefit. Those instructions stated in part that a "finding as to benefit should be based on all the objective facts and inferences presented in the case. You may find that Dr. Gilman or Dr. Ross received direct or indirect personal benefit from providing inside information to Mr. Martoma if you find that Dr. Gilman or Dr. Ross gave the information to Mr. Martom with the intention of benefiting themselves in some manner, or with the intention of conferring a benefit on Mr. Martoma, or as a gift with the goal of maintaining or developing a personal friendship on a useful networking contact." The jury returned a verdict of guilty.

On appeal Mr. Martoma argued that the jury instructions were incorrect an that the evidence was not sufficient to sustain his conviction because *Salman* did not over rule the first prong of the *Newman* gift test requiring evidence of a meaningful close relationship.

The opinions

Dirks acknowledged, the majority noted in an opinion written by Chief Judge Katzmann, that a "tippee who knowingly trades on material nonpublic information obtained from an insider does not necessarily violate insider trading law." That, however, does not always mean that the recipient is free to trade. Whether the recipient of the information inherits the insider's duty to abstain from trading depends on whether the information was obtained improperly which hinges for the most part on the purpose of the disclosure. Specifically, the question is whether the insider receives
some personal benefit. Absent that benefit there is no breach of duty. The benefit can be a *quid pro quo* and it can arise from a gift to a trading relative or friend.

Newman added a gloss to the *Dirks* test, requiring that for a gift there be a "meaningfully close personal relationship." In considering the point the Court noted that "it is not apparent that the examples in *Dirks* support a categorical rule that an insider can never benefit personally from gifting inside information to people other than 'meaningfully close' friends or family members – especially because the justification forconstruing gifts as involving a personal benefit is that '[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient,'" quoting *Dirks.*

Salman "fundamentally altered the analysis underlying *Newman's"* meaningfully close test, according to the majority. While *Dirks* and *Salman* both restricted their discussion of gifts to relatives and friends, particularly in view of the fact that *Salman* involved two close brothers, the "straightforward logic of the gift-giving analysis in *Dirks,* strongly reaffirmed in *Salman,* is that a corporate insider personally benefits whenever inside information is conveyed as a gift if the expectation is that the recipient will trade on the basis of the inside information, obtaining pecuniary gain. This is because the "disclosure is the functional equivalent of trading on the information" by the insider and "giving a cash gift to the recipient." The majority thus held that "we reject, in light of *Salman,* the categorical rule that an insider can *never* personally benefit from disclosing inside information as a gift without a "meaningfully close personal relationship."

Circuit Judge Pooler dissented. The "personal benefit" test was designed as a limiting principle on liability. The rule reflects the principle that notevery disclosure of inside information is a violation of the insider trading laws as the majority acknowledges. This rule protects reporters, stock analysis and others from becoming felons or facing civil liability for communicating information that others use to trade.

Yet the "majority holds that an insider receives a personal benefit when the insider gives inside information as a 'gift' to *any* person. . . the majority strips the long-standing personal benefit rule of its limiting power." This contrasts sharply with the past in which it has bee held that an insider receives a personal benefit "in one narrow situation. That is when the insider gives information to family or friends – persons highly unlikely to use it for commercially legitimate reasons." Indeed, as Justice Breyer noted at oral argument, "'to help a close family member [o friend] is like helping yourself.'"

Salman did not overrule the first prong of the *Newman* test. To the contrary, the Court specifically left it intact, rejecting only the second prong. At the same time the *Salman* Court stressed the close relationship between the two brothers involved there. Yet the "majority today articulates a rule that permits an inference of a personal benefit whenever an insider makes a "gift" of information to *anyone,* not just to relatives or meaningfully close friends." While the majority argues that the rule reaches only "someone he *expects* will trade on the information" in a civil case the actual rule is someone that "the tipper *should have known"* would trade. This rule does not "rescue the majority's weakening of the personal benefit rule." Accordingly,Judge Pooler concluded that he would hold that "an inference of personal benefit may be based on an insider's gift to relatives or friends, but not a gift to someone else."

Comment

The majority and dissent spar over the question of gift giving in the context of insider trading. This results in an interesting analysis which is not necessary to resolve this case.

Dirks is a case focused on limitations. Both the majority opinion and the dissent agree that *Dirks* made it clear that not every communication of inside information constitutes a violation of the insider trading laws. To the contrary, it is only those communications in which there is a breach of duty plus a personal benefit to the insider in which there is liability. The question of gifts, relatives and friends comes into play only when the communication is to such a person or for such a reason. In those instances the personal benefit may be inferred from the relationship. Assessing that relationship must be done based on objective facts, according to the *Dirks* Court.

When these basic principles were applied in *Dirks,* the Court concluded that there was no liability resulting from the communications about Equity Funding by insider Ronald Secrist to analyst Ray Dirks despite the fact that clients of Mr. Dirks traded. This is because the "tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud," according to the *Dirks* Court. Stated differently, the critical question was the reason for the communication and the lack of benefit to Mr. Secrist, not the fact that clients of Mr. Dirks traded.

Newman was also a case about limitations. There the circuit court stated that never had there been a criminal case with such remote tippees. The jury instructions failed to mention the *Dirks* personal benefit test; the court found the evidence on that point wanting. The *Newman* court crafted a limitationor evidentiary test for gifts (quoted above) in view of the potential liability of the remote traders in the case.

Salman, in contrast, was not about limitations but the center of the insider trading rules. The advocates took extreme positions. Petitioner Salman argued for a rule that there is no personal benefit "unless the tipper's goal in disclosing inside information is to obtain money, property, or something of tangible value," according to the Court. The Government claimed that "a tipper personally benefits whenever the tipper discloses confidential trading information for a non-corporate purpose." In the Government's view any communication to a person known to be a trade violates the law. The Supreme Court declined to adopt either position. Rather, the Court concluded that *Dirks* "easily resolves the narrow issue presented here" because the tip was between two brothers with a close relationship, falling squarely within *Dirks*.

Dirks also "easily resolves the narrow issue" presented in *Martoma*. Dr. Gilman was employed not just by the pharmaceutical firms by also an expert network. He had an obligation to maintain the inside information he obtained confidential. He met Mr. Martoma through the expert network. The Doctor knew that Mr. Martoma was seeking information to inform his trades. Unlike Ronald Secrist in *Dirks,* who disclosed inside information not for money, not for friendship but only to disclose a fraud, the Doctor was paid substantial sums of money for *talking to Mr. Martoma while honoring his confidentiality obligations* . The Doctor talked but failed to honor his obligations; the obvious happened – Mr. Martoma used the inside information to trade.

Nevertheless, the issue presented in *Martoma* was one of a *Dirks-Newman* gift. This theory is apparently based in part on the fact that the Doctor did not bill for the two conversations at the end of his relationship when Mr. Martoma was permitted to review the slides for the up-coming public presentation of the trial results. The point may draw support from the fact that over time the two men became friends.

Those facts do not, however, transform a business relationship predicated on specific limitations regarding what could be disclosed into something else. Doctor Gilman was still not authorized to release the information about the drug trials. Mr. Martoma was still a trader looking for information to aid his investment decisions. The relationship was already established; the rules of the relationship and its limitations were in place. To posit otherwise is to ignore the basic facts in an effort to transform the nature of an on-going business relationship and transaction while altering – some might argue contorting – the use of the *Dirks-Newman* gift idea which surely does not include parties trying to skirt the insider trading rules.

While the gift notion may have been presented as the issue in *Martoma* the use of the *Dirks* gift notion has unnecessarily resulted in the dilution of the remaining prong of the *Newman* evidentiary test for gifts. As that evidentiary standard fades and evaporates under the ruling of the majority, the holding tends toward that advocated by the Government in *Salman* which ironically,echoes the initial district court decision in *Newman* – no instruction or evidence on personal benefit,just trading by fourth tier tippees. This is particularly true in civil enforcement cases where a "knew or should have known" standard is applied to the question of what the information provider knew about the tippee's intent to trade.

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The Arguments in *Digital Realty*: A Glimpse of Future Battles

Posted on November 29, 2017 by T. Gorman

The Supreme Court heard argument in *Digital Realty Trust, Inc. v. Paul Somers*, No. 16-1276. The case centers on the question of who is a whistleblower and entitled to the protections of the Dodd-Frank anti-retaliation provisions.

Background

The complaint, filed by former Digital Realty executive Paul Somers, followed his dismissal after lodging complaints about possible securities law violations. The firm's motion to dismiss, arguing that Mr. Somers was not a whistleblower as defined under Section 922 of Dodd-Frank because he did not report to the Securities and Exchange Commission, was denied by the district court. The ninth circuit affirmed. *Somers v. Digital Realty Trust Inc.*, No. 15-17352 (9th Cir. Filed March 8, 2017). That ruling furthered a split among the circuits on the question of whether a whistleblower must file with the SEC or if it is sufficient to lodge a complaint with the firm under the Dodd-Frank provisions. *See Berman v. Neo@Ogilvy LLC*, 801 F. 3d 145 (2nd Cir. 2015)(agreeing with SEC that need not report to the agency first; the SEC also harmonized the statutory provisions with rules); *but see Asadi v. G.E. Energy (USA) LLC*, 720 F. 3d 620 (5th Cir. 2013)(rejecting SEC view).

The case turns on the construction of two Dodd-Frank provisions. One is Section 922(a)(6) which defines a "whistleblower" as "any individual who provides . . . information relating to a violation of the securities laws to the . . ." SEC. The second is Section 922(h)(1)(A), the anti-retaliation provision, which states in part that "No employer may discharge . . . threaten, harass . . . a whistleblower . . . (i) in providing information to the Commission . . . (ii) in initiating, testifying in, or assisting . . . the Commission . . . (iii) in making disclosures that are required or protected under . . . [SOX] and any other law, rule, or regulation subject to the jurisdiction of the Commission."

The argument

The arguments centered on three points. First, the primary position of each party regarding whether the statutory definition of whistleblower applies to all three subsections of 922(a)(6). Second, test for whether the Court could rule in a manner which ignored the statutory definition. Third, if the Commission's rules were entitled to *Chevron* deference.

Petitioner

Petitioner Digital Realty began by framing the question: "The question presented in this case is whether the statutory definition of whistleblower applies to the subsection of the statute [922(a)(6)(iii)] that protects whistleblowers from retaliation from engaging in certain types of conduct. The answer to that question is yes. By its plain terms, the statutory definition applies to the entirety of the section, including the anti-retaliation provision. Far from being absurd, that plain text interpretation is entirely consistent with the history and the structure of the whistleblower provisions and with Congress' overarching objective of promoting reporting to the SEC."

Here Respondent did not report to the SEC. Justice Ginsburg asked about protections for employees who report internally first. Petitioner noted that "where an employee reports internally and then suffers an adverse action in the immediate aftermath of doing so, the Sarbanes-Oxley Act will provide protection." This lead to questions by Justice Sotomayor about one of the so-called anomalies each party claimed resulted from the other's reading of the sections: "So can you please tell me under your reading what we make of subdivision . . . [(ii)]? It protects from discrimination an employee who's been fired for initiating, testifying in, or assisting in any investigation . . . of the Commission. Under what law is the employee who's called by the SEC after another employee reports the violation . . ." protected. Petitioner responded that "I think you point up the reason why we actually think that our interpretation must be correct, and that is because the first and the second clauses . . . were already in the statute at the time that Congress made the judgment . . .[to] replace the broader term 'employees, contractors, or agents' with the narrower term, 'whistleblower' . . . Now, it may very well be that an individual in your circumstance is covered by the Sarbanes-Oxley Act . . ."

Justice Breyer then explored the question of whether the report from the whistleblower actually must be furnished to the SEC under Petitioner's reading of the sections: "A question I would have for both sides really is, what do you think, is there any – could the SEC here promulgate a rule

that would define the manner of reporting to the SEC, which manner would include the class of cases where the report or the information goes to an Audit Committee under circumstances such that, were the Audit Committee and others to do nothing about it, it would likely end up at the SEC's window?"

Petitioner told the Justice that the SEC did not have the authority to write such a rule. To the contrary, to be a whistleblower, the report must be to the Commission. Petitioner went on to note that when the SEC engaged in rule making under the provisions here the notice "tracked the statutory definition and the SEC provided no indication in the notice of proposed rule-making that it was contemplating the possibility of dispensing with that [reporting] requirement." Accordingly, there was no notice until the agency issued the final rule and "converted the one statutory definition of whistleblower into two," covering all three subsections. Thus an invalid notice of rule making was issued, according to Petitioner. And, in any event, the SEC is not entitled to *Chevron* deference here because the sections involved are clear on their face, a position Justice Gorsuch later agreed with.

Respondent

Respondent began by arguing that "Petitioner's reading does create a serious anomaly. If anyone reports to the SEC at any time, it could be half a decade or a decade earlier on a completely unrelated issue, they're a whistleblower for life. So any report they make at a later time is protected even if the information doesn't get to the SEC."

A greater anomaly in Petitioner's potion, according to Respondent, is that "someone who reports internally, as they're often required to do under Sarbanes-Oxley, and they're immediately terminated. And then the second they walk out of that meeting they report to the SEC . . . that person isn't protected under this [Dodd-Frank] provision." Yet the entire reason Congress added subsection (iii) was to strengthen the remedies in SOX, according to Respondent. This is consistent with the fact that Congress recognized that the SOX protections needed to be strengthened.

Justice Gorsuch then began to explore the application of *Chevron* and the SEC's rule making here – a point that repeated throughout the balance of the argument: "I'd like to talk about the notice and comment period . . It seems to me you've got this plain language problem, so you've got to generate an ambiguity. That's the first step of your – your move [under *Chevron*]. Then the second step is that the SEC has reasonably resolved that ambiguity and that we should defer to it . . . then the rule comes out and says reporting to the Commission is not required, in an ipsi dixit unreasoned opinion, one line, basically, and then we have two circuits that actually gave deference to that interpretation. Now, that seems to me to put the whole administrative process on its head . . . Help me out of that scheme."

Respondent walked the Justice through the notice and rule making process, arguing that the SEC had given notice. Citing the notice pages in the Federal Register, Respondent stated that "the agency specifically asked for comments about whether to broaden or change the definition of whistleblower for purposes of the anti-retaliation." And there were three comments on the question. Later the Justice disagreed with Respondent's reading of the notice.

Respondent concluded by arguing that only its reading of the sections gave protection to all those involved in the whistleblowing process: "This is critical whistleblower protections, and we don't see any basis for carving those groups out of the statute."

United States

The Solicitor General began by stating that the "statutory definition of whistleblower is tailor-made for the awards program, but it does not fit in the retaliation programs. Giving the term its ordinary meaning in the retaliation context would harmonize the statute and avoid the anomalies that would result from woodenly applying the statutory definition." This lead to an exchange with Justice Kagan regarding the circumstances under which the Court might actually ignore the definition. By the end of the argument both sides agreed that this could only happen in extreme circumstances to avoid an absurd result.

The Solicitor went on to argue that Petitioner's reading of the sections would "eviscerate the incentive for internal reporting." That would be contrary to what Congress sought to accomplish here which was to "bolster the remedies that were available under Sarbanes-Oxley."

Justice Gorsuch then returned to the question of *Chevron* inquiring "would you agree, though, that a notice-and-comment rule-making that didn't provide fair notice shouldn't be deferred to?" The Solicitor responded: "I think in a properly presented challenge, that – that you wouldn't be able to defer to that. I'll — I'll agree with that, Justice Gorsuch." Justice Breyer followed-up stating "Are you wary of the government conceding that point? I would be wary of that because I don't know what implications it has for other cases where, in fact, you start chipping away in an unforeseen way . . . [it was not] a lifetime concession on the part of the government, is it?" The Solicitor agreed it was not.

Discussion

While the Justices probed each side with questions about "anomalies" and possible inconsistencies, throughout the discussion there seemed to be something of a consensus around the idea that whistleblowers under each subsection were protected. The only question was whether that protection came from SOX or Dodd-Frank. Likewise, there seemed to be little support for the SEC's position or its rules. That is particularly true of Justice Gorsuch who repeatedly returned to the question of *Chevron* and deference and at one point seemed to be trying to extract a concession from the government – but for the follow-up questions from Justice Breyer. That exchange may well be the harbinger of future battles on the Court.

Program: The Fourth Annual Dorsey Federal Enforcement Forum will be held on December 6, 2017. There will be panel discussions and presentation on EPA enforcement, SEC enforcement, investment advisers, international sanctions, FinTec, and FBI international corruption

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