

INSIDER TRADING AND ADMINISTRATIVE COURTS – MORE ON TWO HOT TOPICS THAT HAVE NOW CONVERGED

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Since this blog began in January 2014, several topics have garnered substantial ink. These include: (1) the SEC’s apparent growing preference for litigating contested cases on their home turf, administratively, rather than in federal court. ([June 19, 2014](#), [July 10, 2014](#), [May 26, 2015](#), [May 22, 2015](#)); and (2) the difficulties the government (both the SEC and DOJ) have encountered bringing [insider trading cases](#) and, in particular, the continuing saga of *United States v. Newman*, in which the DOJ’s petition for writ of certiorari is now pending before the United States Supreme Court. Both these issues continue to generate news, and they even converged recently. **SEC’s Administrative Law Courts** On the administrative court front, the SEC has been criticized repeatedly about the potential due process implications of bringing cases, including insider trading cases, in the SEC’s administrative court where there are significant limitations on discovery, very short time periods between initiation of proceedings, and an apparent bias in favor of the agency and against defendants. The agency’s administrative proceedings have also been criticized on the grounds that at least some administrative law judges (ALJs) may not have been appropriately appointed under the Appointments Clause of Article II of the U.S. Constitution. Several defendants have sued the SEC in federal court seeking injunctions of ongoing administrative proceedings. While defendants’ due process arguments thus far have not gotten much traction (see the Seventh Circuit’s decision in *Bebo v. SEC*), multiple district courts have concluded recently that the SEC’s appointment process for its ALJs may violate the Appointments Clause. At least two district courts, in the Southern District of New York (in *Duka v. SEC*) and in the Northern District of Georgia (in *Hill v. SEC* and in *Gray Financial Group v. SEC*), have issued preliminary injunctions halting ongoing SEC administrative proceedings on the grounds that SEC ALJs are not appointed by SEC Commissioners and therefore their appointments are likely unconstitutional violations of the Appointments Clause. Both these cases are currently on appeal. Meanwhile, the commissioners themselves last week in *In re Timbervest* affirmed an ALJ’s decision and, in doing so, expressly addressed some of the constitutional challenges to their proceedings, summarily rejecting them all. Specifically, the commission concluded that its ALJs are employees, not “inferior officers,” because they do not make “final decisions.” As a result, they are not covered by the Appointments Clause. They also concluded that the multiple layers of separation between the president and ALJs did not impair the Executive Branch’s ability to “take Care that the Laws be faithfully executed.” And the SEC concluded that its discretion to bring an action in its administrative forum, rather than federal

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court, did not violate defendants' right to equal protection under the law. Finally, on Sept. 24, the commission announced two sets of proposed changes to its ALJ system. While neither of these proposed revisions addresses the constitutional issues, if adopted, they could potentially level the playing field somewhat. In one proposal, the SEC recommended increasing the length of time between the SEC's initial filing in an enforcement action and the hearing (at least in "appropriate" cases) and allowing for depositions. In the other proposal, the SEC proposed that parties to an SEC action make their filings electronically. Each of these developments demonstrates that the legality of the SEC's administrative adjudications remains very much in question. **Newman Updates** Things are also proceeding apace in the government's effort to get the Supreme Court to reverse the Second Circuit's decision in *Newman*. In early September, the United States filed its reply brief in *Newman*. In it, the government reiterated the positions in its opening brief, arguing that:

1. *Newman* directly conflicts with *Dirks*;
2. *Newman* conflicts with other appellate decisions, including, under the government's view, the Ninth Circuit's decision in *United States v. Salman*;
3. The government's failure to appeal the Second Circuit's "lack of knowledge" determination should not preclude review because a reversal would require the Second Circuit to review this conclusion also; and
4. Leaving *Newman* intact would cause "significant harm" by curtailing antifraud enforcement and decreasing public confidence in the securities markets. The government contends that *Newman* has been "profoundly destabilizing," and review is needed to "restore certainty and order."

Newman is set to be discussed by the Justices in their "long conference" on Sept. 28 (today) which means that a decision on whether the court will hear the case could come sometime this week. Several things to note: (1) the "long conference" is the largest certiorari-related meeting of the year at which the Justices address all of the petitions that have piled up over the court's summer recess (and likely at the end of the preceding term). The justices will discuss nearly 2,000 petitions during this conference. History suggests that petitions reviewed at this conference are granted only half as often as those addressed at other times of year; (2) In addition to deciding to grant or deny certiorari or deny it at that conference, Supreme Court watchers have noted that the court increasingly "holds over" petitions for a subsequent conference. Statistically, doing so increases the likelihood that the court will ultimately grant certiorari. Since the vast majority of petitions will be denied at this conference, perhaps the best outcome the government can hope for is that the *Newman* petition will be held over for later consideration. We'll know something more shortly. Meanwhile, back in the Southern District of New York, Judge Jed Rakoff handed the SEC a win earlier this month when he denied defendants' efforts to apply the *Newman* standard to the SEC's civil enforcement action in *SEC v. Payton*. Judge Rakoff denied defendants' summary judgment motion and sided with the SEC, concluding that, unlike in a criminal action, the agency need not prove that defendants knew that the initial tipper received a meaningful "personal benefit" in exchange for the disclosed inside information. The court did not explain its rationale, but the SEC had argued that it was entitled a lower burden of proof (*i.e.*, recklessness, as opposed to knowledge of personal benefit, and a lower

quantum of personal benefit) than is required under *Newman*. However, the court also indicated that, in light of the pending *Newman* petition for certiorari, and the possibility that the Supreme Court could ultimately alter the *Newman* analysis, he would give any party the opportunity to seek a stay pending *Newman*'s final resolution. Defendants indicated that they would request such a stay. **The SEC Loses An Insider Trading Case On Its Home Court** These two topics converged in mid-September in *In re Ruggieri*. There, an SEC ALJ dismissed a civil insider trading case based on *Newman*. Like the commission in *Timbervest*, the ALJ first dismissed Ruggieri's constitutional challenges based on the Appointments Clause and the argument regarding the multiple strata between the President and the ALJs. However, on the merits, the ALJ sided with Ruggieri. The ALJ applied *Newman* and concluded that the agency did not show that the tipper (Bolan) gave Ruggieri inside information in exchange for a personal benefit. In doing so, contrary to the Government's *Newman* petition, the ALJ stated that he "d[id] not . . . read *Newman* as conflicting with *Dirks*." Rather, he believed it simply "clarif[ied] the standard where proof of a personal benefit is based on a personal relationship or friendship." The SEC adequately demonstrated that the tipper (Bolan) provided inside information to others, including Ruggieri, on multiple occasions. However, the SEC had only demonstrated that Ruggieri gave the tipper general career advice and that the two simply had an "amicable working relationship" rather than a meaningful, close, or personal friendship. As a result, the ALJ concluded that the SEC had not shown that Ruggieri provided Bolan any meaningful "personal benefit" in exchange for the inside information or that the two shared a sufficiently close relationship. *Ruggieri* does not demonstrate that the SEC's administrative court is a level playing field or lacks the constitutional infirmities being challenged in federal court; however, at least in this instance, it shows that a defendant can sometimes still prevail before the SEC. It might also suggest that the SEC's newer ALJs (Judge Patil is the newest and has only been an ALJ for a year) might be less institutionally-aligned and more independent than more seasoned ALJs. Only time will tell if that is the case and what the repercussions of that independence might be.