

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—2nd Cir.: SEC seeks relief from injunction in Duka challenge to agency ALJ proceeding, (Aug. 27, 2015)

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By Kevin Kulling, J.D.

The SEC filed a Notice of Appeal with the Second Circuit seeking relief from a district court's entry of a preliminary injunction that required the agency to halt administrative proceedings against former S&P managing director Barbara Duka. In addition, the SEC requested that the district court stay its preliminary injunction pending its appeal (*Duka v. SEC*, August 26, 2015).

History. The SEC instituted administrative proceedings in January 2015, alleging that Duka, the former head of S&P's Commercial Mortgage Backed Securities Ratings Group, violated anti-fraud provisions of the securities laws related to alleged false and misleading statements by S&P concerning its post-financial crisis methodology for rating commercial mortgage-backed securities.

Duka sought a preliminary injunction to halt the SEC proceedings, arguing that ALJs are "inferior officers" under the Constitution, which requires that they be appointed by the President, department heads, or a court of law.

Because the SEC ALJs involved in the administrative proceeding against Duka were not appointed by the SEC, they were not appropriately appointed and were thus in violation of the Constitution's Appointment Clause, according to Duka.

On August 12, 2015, the federal district court in Manhattan entered a preliminary injunction against the SEC, ordering the agency to halt its administrative proceedings against Duka. In addition to determining that forcing Duka to proceed would cause her irreparable harm, the court agreed with Duka's analysis that the SEC administrative law judges (ALJs) were likely not appropriately appointed under the U.S. Constitution.

On August 26, 2015, the SEC filed its Notice of Appeal and in a letter to the district court, sought a conference at the earliest possible date with respect to the SEC's contemplated motion to stay pending the appeal of the preliminary injunction. The court granted Duka until September 1, 2015 to respond to the SEC's stay request.

SEC letter. In its letter seeking a stay of the preliminary injunction, the SEC asserted that it is likely to prevail in the Second Circuit. To start, the SEC said, the district court lacks jurisdiction over the matter, citing a Seventh Circuit decision in a similar matter where the court ruled that it is "fairly discernable from the securities laws that Congress intended Plaintiffs bringing Article II challenges to SEC administrative proceedings to proceed exclusively through the statutory review scheme." The SEC also referred to a Second Circuit opinion that the securities laws generally require respondents in SEC administrative proceedings to bring challenges in "the Court of Appeals or not at all." Based on "overwhelming precedent," the SEC said that it is likely to prevail on the jurisdictional issue.

Secondly, the SEC argues that it is likely to prevail on the merits because SEC ALJs are not inferior officers.

SEC ALJs do not possess final decision making authority and an SEC ALJ is "acting merely in aid of his employing agency, which retains plenary authority over the entire administrative process," according to the SEC.

Moreover, a stay is proper, the SEC said, because the SEC has expended significant resources preparing for the administrative enforcement hearing and the injunction issued by the district court causes irreparable harm because it interferes with the SEC's ability to enforce the securities laws and deter future violations.

The SEC has a statutory duty to ensure that Nationally Recognized Statistical Rating Organizations (NRSROs) such as S&P and their affiliates comply with statutory and regulatory obligations, according to the SEC. In discharging its duties, the SEC sought to bar Duka from associating with an NRSRO in the future. The SEC said that it and the public have a strong interest in the prompt adjudication of the SEC's allegations and a determination on whether a bar is appropriate to protect investors and promote integrity of the ratings industry.

In light of the “ongoing harm suffered by the SEC” during the pendency of the preliminary injunction, the SEC asked the Court to expedite its consideration of the SEC’s request. The matter is set for a conference with the court on September 16, 2015. The court declined to grant a stay prior to the conference.

Attorneys: Daniel Zachary Goldman (Petrillo Klein & Boxer LLP) for Barbara Duka. Adam Grogg, U.S. Department of Justice for the SEC.

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