ORAL ARGUMENT REQUESTED

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

EGAN JONES RATING COMPANY and SEAN EGAN, Plaintiffs, v. UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Defendant.	Civil Action No. 1:12-CV-00920-ABJ

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS

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Sean Egan and Egan-Jones Ratings Company ("Egan-Jones") seek three forms of relief that, to our knowledge, have never before been sought from a federal court, and two forms of relief only once sought but never resolved. The issues presented and relief requested go to the heart of the conduct of and practice before a federal agency of the United States, the United States Securities and Exchange Commission ("SEC" or "Commission"), and are supported in the case law. While the Commission in its Motion to Dismiss seeks unprecedented deference to its Administrative Proceeding, the Commission overlooks two very important facts. An SEC Administrative Law Judge does not have the authority to issue an injunction. And, an SEC Administrative Law Judge does not have the authority to issue a declaratory judgment. This Court is, therefore, the only forum in which the Plaintiffs can seek relief.

The relief sought here is: (1) a declaratory judgment that the SEC may not apply the civil penalty provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 Act ("Dodd-Frank Act") against Egan-Jones and Mr. Egan retroactively; (2) a declaratory judgment that the SEC's delegation of authority to issue administrative orders of investigation and to designate officers of the SEC for the purpose of such investigation to the agency's Division of Enforcement ("Enforcement") violates the Administrative Procedure Act; and (3) a permanent injunction enjoining select members of the staff of the SEC's Office of Compliance, Inspections and Examinations ("OCIE"), who served as officers of an investigation under the Enforcement, from conducting and participating in inspections and examinations only of Egan-Jones.

In 2011, a plaintiff in a similar case sought what are Egan-Jones' and Mr. Egan's fourth and fifth forms of relief – a permanent injunction enjoining the SEC from pursuing its Administrative Proceeding against them administratively and from otherwise violating their Due

Process, Equal Protection and First Amendment rights, and an Order removing the Administrative Proceeding and all further proceedings against them to this federal court. In that case, the Commission dismissed its Administrative Proceeding and re-filed its case in federal court.

Before this Court, right now, is a Motion to Dismiss based upon the adequacy of Egan-Jones' and Mr. Egan's pleadings. As discussed in this Opposition, Egan-Jones and Mr. Egan have satisfied fully and robustly the pleading standards for this Court to deny the Commission's Motion to Dismiss and enable this Court to resolve these ripe issues central to the regulatory oversight and enforcement functions of a federal agency.

PRELIMINARY STATEMENT

As we allege in the Complaint, the administrative proceeding which the Commission instituted against Plaintiffs is an attempt to diminish and marginalize Plaintiffs' voice and role in the credit ratings market while supporting and maintaining the status quo of a virtual monopoly for the large issuer-paid ratings agencies (including the largest issuer-paid agencies – Moody's Investor Services ("Moody's), Standard & Poors ("S&P") and Fitch Ratings ("Fitch")). Those large issuer-paid ratings agencies issued inaccurate ratings on structured financial products which "contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world." 15 U.S.C.A. § 78o-7.

This Congressional sentiment is based on overwhelming evidence. In addition to the 635 page April 13, 2011 Levin-Coburn Report on the Financial Crisis , which includes at least 88 pages on the central and critical role of the largest issuer-paid ratings agencies (*see* pages 5-11, 13-14, 26-32, 243-317) , and numerous books and scholarly articles on the subject,

approximately 30 lawsuits have been filed against, variously, S&P, Moody's and Fitch arising out of their ratings and remuneration from such ratings of Asset Backed Securities ("ABS") from 2003 into 2007.

Attorneys general or law firms representing the public employees retirement funds of the states of Indiana, California, New Jersey, Connecticut and Illinois have filed these lawsuits against the three large ratings agencies. In addition, lawsuits have been brought on behalf of banks, union locals, private retirement plans and school districts. These lawsuits have included allegations of malfeasance, that these ratings agencies knowingly issued false, inflated and misleading ABS ratings for significant profit and to win business; that they applied outdated or intentionally lax methodologies to inflate the ratings; and that they failed to implement internal policies and controls to prevent this wrongdoing. Together, these lawsuits have alleged many billions of dollars in losses from ABS ratings wrongfully inflated to secure huge issuer paid fees and additional business.

As President Obama explained during the October 3, 2012 Presidential debate:

> The reason we have been in such an enormous economic crisis was prompted by reckless behavior across the board.
>
> Now, it wasn't just on Wall Street. You had loan officers were -- that were giving loans and mortgages that really shouldn't have been given, because the folks didn't qualify. You had people who were borrowing money to buy a house that they couldn't afford. You had credit agencies that were stamping these as A1 great investments when they weren't.

No claim of an inflated or corrupted rating has ever been made against Egan-Jones in any ratings classification, including ABS. No one has ever lost a dime from an Egan-Jones rating. Egan-Jones is the only independent NRSRO and historically has been paid only by subscribers. To the contrary, Egan-Jones warned its subscribers about the precarious and dangerous ABS

exposure (created by the large ratings firms' inflated ABS ratings) carried on the books of Fannie Mae and Freddie Mac and various corporate finance companies well before the seize-up of the US credit markets and the 2008 US financial collapse.

Targeting Plaintiffs is thus in direct contravention of specific Congressional direction in both the Credit Rating Agency Reform Act of 2006 ("Reform Act") and the Dodd-Frank Act to encourage competition in the credit ratings market as a means to reduce the corrupting effects of the conflicted issuer-paid ratings agency business model of the large agencies.

None of the allegations in the administrative proceeding concern the accuracy of a single rating issued by Plaintiffs, nor do they allege that anyone was harmed by any rating. The Commission's decision to target a small, independent, subscriber-funded ratings agency, where it has chosen not to bring administrative or civil injunctive enforcement proceedings against the large issuer-paid firms for similar and far more egregious and injurious conduct, is inexplicable other than as unjust and arbitrary. The Commission's disparate and unjust treatment of Plaintiffs has its roots in Plaintiffs' criticism of the issuer-paid model which the Commission favors as a function both of bureaucratic stasis and of the revolving employment door between the Commission and the largest issuer-paid ratings agencies.

In its brief, the Commission's only response to the substantive and substantial allegations of Plaintiff's Complaint is that "[t]he thrust of Plaintiffs' Complaint appears to be that because they have a different business model than other companies that offer credit ratings, a business model they believe is superior, the SEC is biased against them and in favor of the companies that have a different business model." (*See* SEC Mem. at 11.) The detailed factual allegations of the disparate treatment of Plaintiffs set forth in the Complaint stem not only from Egan-Jones's subscriber-paid business model," but are otherwise only explainable as an institutional bias and

preference for the status quo firms and a unjustly negative view of Egan-Jones expressed by the Commission from the very beginning of Plaintiffs' NRSRO application process through the inexplicable and unprecedented leak to Reuters of the Commission's non-public, scheduled vote as to whether to commence an administrative proceeding and the likely allegations. Nor is the greater accuracy and reliability of the ratings issued by Plaintiffs a subjective self-serving opinion as the Commission suggests; it is, instead, the conventional wisdom of the financial news media and independent scholarly literature.

In their Complaint, Plaintiffs plead causes of action and stated facts in support of their allegations and argument that the Commission's disparate treatment of them from the NRSRO application stage through the institution of the administrative proceedings amounted to violations of Plaintiffs' Due Process, Equal Protection and First Amendment Rights. The Commission confines their entire Motion to Dismiss to essentially one argument: this Court does not have subject matter jurisdiction to hear this suit. As discussed below, this suit raises fundamental and important questions of constitutional law, and is properly before this Court pursuant to both general federal question jurisdiction and the Administrative Procedure Act ("APA") as interpreted by the United States Supreme Court and other federal courts.

ARGUMENT

I THERE IS NO BAR TO A LEGITIMATE CONSTITUTIONAL CHALLENGE OF AN AGENCY'S ACTIONS, AND SOVEREIGN IMMUNITY HAS BEEN WAIVED FOR ACTIONS AGAINST THE COMMISSION

The Administrative Procedure Act ("APA") provides that "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof." 5 U.S.C.A. § 702. The APA creates no bar to a legitimate constitutional challenge to an agency rule or policy in a federal district court. *Nat'l Fed'n of Fed. Emps. v. Weinberger*, 818 F.2d 935, 942 n.11 (D.C. Cir.

1987). Plaintiffs bring this suit, *inter alia*, pursuant to this section of the APA (Compl. ¶ 13), and are not precluded from doing so. Section 702, by its plain language, waives sovereign immunity for actions against an agency, such as Plaintiffs' action here, that seek relief other than money damages. *Bowen v. Mass.*, 487 U.S. 879, 893 (1988). "[T]he APA's waiver of sovereign immunity applies to any suit whether under the APA or not" because Section 702 "waives sovereign immunity for [any] action in a court of the United States seeking relief other than money damages," not solely for an action brought under the APA. *Trudeau v. Fed. Trade Comm'n*, 456 F.3d 178, 186 (D.C. Cir. 2006) (citations omitted).

In fact, because district courts have federal question jurisdiction under 28 U.S.C. § 1331, the "normal default rule" is that "persons seeking review of agency action go first to district court rather than to a court of appeals." *Int'l Bhd. Of Teamsters v. Pena*, 17 F.3d 1478, 1481 (D.C. Cir. 1994); *see Oryszak v. Sullivan*, 576 F.3d 522, 524-25 (D.C. Cir. 2009) (quoting *Califano v. Sanders*, 430 U.S. 99 105 (1977) ("Rather, the court had subject-matter jurisdiction pursuant to the so-called federal question statute, 28 U.S.C. § 1331, which grants the district court original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States and thereby confer[s] jurisdiction on federal courts to review agency action.") (internal quotations omitted)); *Chrysler Corp. v. Brown,* 441 U.S. 281, 317 n.47 (1979) ("Jurisdiction to review agency action under the APA is found in 28 U.S.C. § 1331"); *Ass'n of Nat'l Advertisers v. FTC*, 617 F.2d 611, 619 (D.C. Cir. 1979) ("General federal question jurisdiction … gives the district courts the power to review agency action absent a preclusion of review statute.").

II. SECTION 78y OF THE SECURITIES EXCHANGE ACT OF 1934 DOES NOT BAR PLAINTIFFS FROM SEEKING REVIEW OF COMMISSION ACTIONS IN THIS COURT BECAUSE PLAINTIFFS ARE NOT SEEKING JUDICIAL REVIEW OF A FINAL SEC ORDER

Administrative Procedure Act § 703 provides:

> The form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute, or in the absence of inadequacy thereof, any applicable form of legal action, including actions for declaratory judgment or writs of prohibitory or mandatory injunction or habeas corpus.

5 U.S.C. § 703. In turn, Section 78y provides one potential avenue for review of administrative action by the federal courts:

> A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

15 U.S.C. § 78y.

Initial review occurs at the appellate level only when a direct-review statute specifically gives the court of appeals subject-matter jurisdiction to directly review agency action. *Watts v. S.E.C.*, 482 F.3d 501, 505 (D.C. Cir. 2007) (citing *Int'l Bhd. Of Teamsters v. Pena*, 17 F.3d at 1481). Litigation choices by agencies are not the kinds of agency determinations that are channeled to courts of appeals under the direct-review statutes. *See id.* at 507 (collecting cases). Moreover, APA § 703 provides a clear roadmap for what to do if the "form of proceeding for judicial review[,] the special statutory review proceeding[,]" is either "absent or inadequate." Then, "the form of proceeding" is "any applicable form of legal action, including actions for declaratory judgment or writs of prohibitory or mandatory injunction or habeas corpus, in a court of competent jurisdiction." 5 U.S.C. § 703. That is the precise nature of the instant suit.

The Commission argues that Plaintiffs are precluded from filing suit in this Court to challenge their disparate treatment by the Commission over the last five years, which culminated in the filing of the administrative proceeding, because the Order instituting those proceedings is not ripe for review pursuant to Section 78y, which provides for judicial review to "a person aggrieved by a final order of the Commission." The linchpin of the Commission's argument that this Court lacks subject matter jurisdiction is that Section 78y is the "special statutory review proceeding" for purposes of APA § 703 (SEC Mem. at 15 ("Here, Exchange Act Section 25(a) provides the special statutory review proceeding prescribed in APA Section 703 for seeking judicial review of SEC orders and vests exclusive jurisdiction with the courts of appeals")), which the Commission avers means that "[a]s the federal securities laws provide for judicial review of SEC administrative proceedings in a court of appeals, Egan and Egan-Jones cannot seek relief in this Court." (*Id.* at 18.) However, by its plain terms, Section 78y governs only the procedure for review of a "final order of the Commission." Plaintiffs are not seeking review of a Commission "final order." They are, in fact and instead, seeking, in addition to removal for the reason stated in the Complaint, a declaratory judgment that: (1) the Commission may not apply to them retroactively the civil penalty provisions of the Dodd-Frank Act to them; (2) the Commission, during its investigation of Plaintiffs, violated the APA by delegating authority to the Division of Enforcement to (a) issue a formal order of investigation and (b) designate officers of the Commission for the purpose of the investigation; and (3) an injunction to prohibit certain members of OCIE who crossed over from regulatory examinations into the confidential cloaked arena of enforcement investigations from spinning back into a regulatory examination role only as to Egan-Jones. (Compl. at 64-65.)

The term "order" in Section 78y is not defined by either the Securities Act of 1933 or the

Securities Exchange Act of 1934. As such, it is appropriate to look to the APA for a definition. *See APCC Servs. v. Sprint Comm'ns Co.*, 418 F.3d 1238, 1249 (D.C. Cir. 2005) (looking to APA when interpreting "order" in 47 U.S.C. §§ 407, 416(c)). The APA provides that an "order" is "the whole or a part of a final disposition, whether affirmative, negative, injunction, or declaratory in form, of an agency in a matter other than rule making." *Watts,* 482 F.3d at 505-06 (citing 5 U.S.C. § 551(6)).

This Court has jurisdiction to review Plaintiffs' challenge because the Commission's actions do not constitute "the whole or a part of a final disposition" of the Commission "in a matter other than rule making." *See Id*. In *City of Philadelphia v. SEC*, 434 F. Supp. 281 (E.D. Pa. 1977), the court did not deem an "order" to include the Commission's investigation, and the court accepted jurisdiction of a case presenting constitutional challenges to the initiation of the investigation. In that case, the court found that 78y, by providing for "final order" review only in the courts of appeals, did not deprive the district court of power to take jurisdiction of cases presenting constitutional challenges to "preliminary" investigations in which no investigatory "order" has been issued and to review the issues in accordance with the APA.

The Commission cites *Nassar & Co. v. SEC,* 566 F.2d 790, 792 n.3 (D.C. Cir. 1977), for the proposition that Section 78y deprives district courts of jurisdiction to hear actions seeking to declare a Commission order void. (SEC Mem. at 17). However, Plaintiffs are not seeking to declare a Commission order void. By the SEC's own admission (*id.* at 18), the Order Instituting Proceedings is not a final order ripe for review pursuant to Section 78y, and, there is no final order yet on the allegations as the administrative proceedings are still before the administrative law judge. Only after a hearing will an initial order be entered by the ALJ, and only after an appeal to the Commission will a final order be entered. Here, instead, Plaintiffs are seeking

review of a pattern of disparate treatment from 2007-12, and relief that is beyond the authority of an agency administrative law judge.

Additionally, unlike the action filed in the Supreme Court's decision, *Fed. Trade Comm'n v. Standard Oil Co.*, 449 U.S. 232 (1980), relied on by the Commission (SEC Mem. at 18-20), which sought "[j]udicial review of the averments in the [Federal Trade] Commission's complaints" before the conclusion of the administrative proceedings, the purpose of this action is not to seek to challenge the factual accuracy and merits of the allegations in this Court. Rather, Plaintiffs challenge the Commission's unfair and arbitrary treatment of Plaintiffs leading up to and including the filing of the administrative proceeding. While Plaintiffs certainly will defend against the Commission's allegations, in any forum including before this Court, the factual accuracy of the Commission's allegations is not the gravamen of the relief sought in this Court.

III. THIS LAWSUIT CHALLENGING THE COMMISSION'S ACTIONS MAY BE BROUGHT IN THIS COURT BECAUSE THE STATUTORILY PROVIDED REVIEW OF SEC ORDERS BY THE COURTS OF APPEALS IS ABSENT AND INADEQUATE IN THIS CASE

Administrative Procedure Act § 703 and 1934 Act Section 78y do not together provide exclusive jurisdiction for federal court review of the claims asserted in this action to only a federal court of appeals as the Commission argues. Those statutes, instead, by their plain terms, allow for the precise action which Plaintiffs have filed when the special statutory proceeding is either "absent or inadequate." Here, a "special statutory proceeding" is "absent" because Plaintiffs are not seeking review of "final orders," and is "inadequate" for the myriad reasons discussed below.

The Commission requests that this Court find that Section 78y is the only manner in which Plaintiffs can access any federal court, district or appellate, for review of Commission actions. (*See, e.g.*, SEC Mem. at 15, 22-23 (arguing there is "exclusive jurisdiction with the

courts of appeals").) But that argument is flawed. In a recent decision, in fact the only other case requesting that a federal court order removal of an SEC administrative proceeding based on many of the same constitutional and other arguments alleged here, the United States District Court for the Southern District of New York, a court rejected this argument by the Commission:

> [I]f federal law gives the SEC exclusive jurisdiction to remedy, at least in the first instance, the constitutional and other infirmities of which Gupta complains, then he has to exhaust these remedies first. *See United States ex rel. St. Regis Mohawk Tribe v. President R.C.-St. Regis Mgmt. Co.*, 451 F.3d 44, 50 (2d Cir. 2006). But as the Supreme Court held in *Free Enterprise* … the SEC does not have exclusive jurisdiction over challenges to SEC-related actions that meet certain criteria, arguably present here. And, as the Second Circuit stated in *Touche Ross & Co. v. SEC*, 609 F.2d 570 (2d Cir. 1979), in which appellants challenged the SEC's legal authority to proceed against them pursuant to a newly-promulgated SEC rule, "[w]hile the Commission's administrative proceeding is not 'plainly beyond its jurisdiction,' nevertheless to require appellants to exhaust their administrative remedies would be to require them to submit to the very procedures which they are attacking." *Id.* at 577.

Gupta v. S.E.C., 796 F. Supp. 2d 503, 510 (S.D.N.Y. 2011).

In *Gupta*, as here, "the SEC contends that the two provisions together establish[ed] that review of any SEC proceeding is available only in a United States Court of Appeals and only after the administrative proceeding is completed[.]" *Id.* at 511. In reality "the two statutes, on their face, provide that a lawsuit challenging any action by the SEC may be brought in any court of competent jurisdiction if the statutorily-provided review of final SEC orders by the courts of appeal is in some relevant respect inadequate." *Id.*

The Commission overstates the significance of the Second Circuit's decision in *Altman v. S.E.C.*, 687 F.3d 44 (2d Cir. 2012), as "implicitly reject[ing] the *Gupta* rationale." (SEC Mem. at 27-28.) The district court in *Altman* dismissed an action against the Commission for lack of jurisdiction based on § 25(a). *Gupta*, decided by the same district court a few months later, specifically confronted and distinguished the reasoning in *Altman.* According to the court,

"[w]hile in some cases" the district court may determine that Section 78y taken together with Section 703 of the APA "limits the Court's jurisdiction, *see, e.g.*, *Altman v. SEC*, 768 F. Supp. 2d 554 (S.D.N.Y. 2011), no such limit applies in cases that meet the three criteria stated in *Free Enterprise." Gupta,* 796 F. Supp. 2d at 512.

The Second Circuit, in a brief, *per curiam* opinion, affirmed the *Altman* district court's findings that, under the facts of the case at bar, the district court's jurisdiction was limited. However, the Commission makes no attempt to align the facts of *Altman* with the facts in *Gupta* or those present in this case. In contrast to Plaintiffs' and Gupta's near immediate challenge to the Commission's decision to institute an administrative proceeding, Altman's case had already run its course before the administrative law judge and been appealed from and decided by the Commission as of November 2010. *See Altman,* 768 F. Supp. 2d 554. Only when faced with the unfavorable result of the Commission's decision did Altman then seek relief in the district court in December 2010 instead of following the procedure outlined by 78y. *See id.* at 557-58. Altman was specifically seeking *vacatur* of an SEC "final order," *id.* at 558, whereas Gupta sought and Plaintiffs are seeking to prevent the administrative proceeding from ever going that far, requesting immediate injunctive relief to halt an ongoing violation of constitutional rights.

Congress does not intend to limit jurisdiction for review of agency action if: "a finding of preclusion could foreclose all meaningful judicial review"; the suit is "wholly collateral to a statute's review provisions"; and the claims are "outside the agency's expertise." *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3150 (2010) (citing *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212-13 (1994)).

IV. LIMITING JURISDICTION TO A FEDERAL COURT OF APPEALS FOR REVIEW OF THE CLAIMS IN THIS AGENCY ACTION WOULD FORECLOSE ALL MEANINGFUL JUDICIAL REVIEW

As per the Supreme Court's decisions in *Free Enter. Fund* and *Thunder Basin Coal Co.*, a finding of preclusion would foreclose all meaningful review.

The practical effect would be forcing Plaintiffs to wait for what might be two years, if not longer, for a federal court of appeals to hear these claims only after the proceeding whose very legitimacy and existence Plaintiffs challenge first ran its course before the administrative law judge and second, after an appeal to the Commission. As Plaintiffs make clear in their Complaint, the relief they are seeking is not related to the specific allegations in the OIP. Plaintiffs are not permitted to raise claims for affirmative declaratory and injunctive relief in the course of the administrative proceeding.

Plaintiff's constitutional claims rely necessarily in part on evidence uniquely in the possession of the Commission, regarding the irrational, arbitrary, unjust and discriminatory decision to treat Plaintiffs differently from the large issuer-paid ratings agencies. Plaintiffs have some of this evidence either from the record of their past dealings with the Commission or from the public domain. Plaintiffs are trying to obtain additional evidence in the administrative proceeding but are being prevented from doing so. The Commission's Rules of Practice are narrower than the Federal Rules of Civil Procedure. To seek documents and depositions that a litigant would be able to request without prior permission as a matter of course, respondents in Commission administrative proceedings need to request the opportunity to issue subpoenas, which the administrative law judge may deny, and which the Commission has the ability to avoid or frustrate by motion to quash. *Compare* F. R. Civ. P. 30 ("A party may, by oral questions, depose any person, including a party, without leave of court[.]) and 34 (providing that a "party may serve on any other party a request … to produce and permit the requesting party or its

representative to inspect, copy, test, or sample the following items in the responding party's possession, custody, or control: (A) any designated documents or electronically stored information") with Comm. R. Prac. 232 (a) (providing that "a party may request the issuance of subpoenas requiring the attendance and testimony of witnesses at the designated time and place of hearing, and subpoenas requiring the production of documentary or other tangible evidence returnable at any designated time or place"), 232(b) (providing for administrative law judge discretion to deny requests for subpoenas) and 232(e) (providing for opportunity to move to quash subpoenas otherwise approved).

With a significantly restricted ability—or, more fairly, an absolute inability—to assert claims against the Commission and secure discovery in development of those claims, the record to the court of appeals will contain little record of or information relevant to the claims and arguments which the Plaintiffs assert here.[1]

Additionally, the Commission, having approved the administrative proceeding, is inherently conflicted in assessing the claims here. The allegations in the Complaint make plain the documented bases for its concerns that the Commission has an institutional bias against Plaintiffs that compromises the integrity of the administrative appellate review process. (Compl. ¶ 176 ("[I]n this unique set of circumstances the SEC's own actions have made it so that Egan-Jones and Mr. Egan will not be afforded sufficient safeguards in the Administrative Proceeding, particularly given that oversight of the independent Administrative Law Judges and the appeal of

[1] Additionally, when federal district courts and courts of appeals review agency determinations in the face of a petitioner's claims of agency bad faith and bias, those courts look behind the traditional administrative record. *See Tummino v. Torti*, 603 F. Supp. 2d 519, 542-49 (E.D.N.Y. 2009) ("Moreover, 'proof of subjective bad faith by [agency decision-makers], depriving a [petitioner] of fair and honest consideration of its proposal, generally constitutes arbitrary and capricious action'" (quoting *Latecoere Int'l v. U.S. Dep't. of Navy*, 19 F.3d 1342, 1356 (11th Cir. 1994)); *Contracting Consulting Engineering LLC v. United States*, 104 Fed. Cl. 36, 38 (Fed. Cl., 2012) ("A court cannot examine agency actions that are assailed as a conflict of interest, bias, or other extra-legal activity without considering evidence that was not before the agency when the administrative decision was made.") Thus, the evidence that the Commission now seeks to keep out of the administrative record would be considered relevant to a federal court, either at the district or appellate level, in assessing the merits of Respondents' claims of bias.

any decisions by the Administrative Law Judges vests in the SEC that, through its staff and by its leak, compromised its dealings with Egan-Jones and Mr. Egan.").)

Indeed, the Agency appears conflicted. There appears to be a substantial economic relationship between the SEC and the largest issuer-paid firms, a relationship in which employment opportunities flourish between them. The "revolving door" problem at the SEC is a significant enough issue for Congress to require in the Dodd-Frank Act that the SEC issue a report on the question. The issue looms large here as perhaps a very substantial reason for the different treatment between the large issuer-paid firms and the small subscriber based firms—of which Egan-Jones is the only NRSRO left.

The largest issuer-paid NRSRO's—Moody's, Standard & Poor's, and Fitch—are a significant source of employment opportunities for SEC staff members before and after working for the SEC. Comparatively, Egan Jones at this point cannot provide employment opportunities for staff at the SEC responsible for the regulation of NRSRO's. Because of their economic interest in the largest issuer-paid firms, the SEC as an institution and its personnel, as Congress recognized, may well be influenced and biased in their favor. There really appears no other logical explanation for the SEC's warm embrace of firms that destroyed the U.S. economy with knowingly inflated ABS ratings and the SEC's effective war on tiny Egan-Jones, which has harmed no one, made no money on its ABS or sovereign ratings, and clearly warned the market well before the 2008 crash about the inflated ABS ratings issued by the largest NRSRO's—for which those firms collectively made billions of dollars. Little else can account for the clear differential treatment of smaller NRSRO's compared to larger NRSRO's for application misstatements (OIP's against smaller NRSRO's Lace Financial and Egan Jones for alleged application misstatements, "21(a) Reports" and other non-action against Moody's, Standard &

Poor's and Fitch for application misstatements relating to falsely inflated ratings).

Federal law provides that if government employees have such conflicts of interest, they should be disqualified in the event "participation in a particular investigation or prosecution if such participation may result in a personal, financial, or political conflict of interest, or the appearance thereof." 28 U.S.C. § 528.

Additionally, there is authority in this Circuit for the proposition that when, as here, broad systemic charges of violations of constitutional rights are asserted against the agency, the relevant inquiry is whether the text of the relevant jurisdictional statutes permit the claims. *See Elk Run Coal Co. v. U.S. Dep't of Labor*, 804 F. Supp. 2d 8, 16-22 (D.D.C. 2011). In *Elk Run Coal*, this Court rejected an agency's attempt to have due process claims against it dismissed based on lack of subject-matter jurisdiction. The Department of Labor, like the Commission here, argued that jurisdiction in the district court was precluded by an exclusive review scheme. This Court noted the D.C. Circuit's rejection in *General Elec. Co. v, Jackson*, 610 F.3d 110 (D.C. Cir. 2010), of the EPA's argument that "plaintiffs like GE who seek to bring pattern and practice challenges first show that the statute provides no meaningful judicial review for their claims." *Elk Run Coal,* 804 F. Supp. 2d at 21 (citing *General Electric Co.,* 610 F.3d at 125). This Court noted the D.C. Circuit's finding in *General Elec. Co.* that the jurisdiction-stripping provision presented no bar to a pattern and practice suit and did not depend on the unavailability of alternative means of judicial review, but instead on the Court's analysis of the "jurisdictional provision's text." The jurisdictional statutes at issue in *Elk Run* described the review that a procedure a mine operator must follow to contest "the issuance or modification of an order[,] ... citation[,] ... notification of proposed assessment of a penalty[,] ... or the reasonableness of the length of abatement time fixed in a citation," finding that nothing in that statute or other

jurisdictional statutes precluded broad constitutional due process challenges. Similarly, nothing in the text of 78y provides for a bar on the claims of systemic constitutional violations here.

A. The Commission's Argument As To The Second Relevant Inquiry Under *Free Enterprise* & *Thunder Basin* Is Without Merit

The Commission argues vigorously and repeatedly that Plaintiffs cannot show that their claims in this lawsuit are collateral to the administrative proceeding by noting the supposed identity between the affirmative defenses Plaintiffs asserted in the administrative proceeding and the causes of action in the Complaint. (SEC Mem. at 2 ("Plaintiffs have asserted as affirmative defenses in that proceeding ***essentially the same allegations*** they rely upon in asking this Court to enjoin the SEC from conducting the proceedings and to 'remove' the proceeding to federal court.") (emphasis added); *id.* at 3 (arguing that Plaintiffs cannot meet the collateral "test because the affirmative defenses to the administrative proceeding that they seek to litigate in this Court are not wholly collateral to the statutory review scheme provided."); *id.* at 10 ("These [affirmative] defenses ***largely mirror the allegations*** of the Complaint.") (emphasis added); *id.* at 30 ("Significantly, [Plaintiffs] are asserting before the affirmative defenses ALJ they seek to litigate here."); *id.* at 31 ("As discussed above, they have raised in the administrative proceeding all the defenses they seek to raise here.").)

There are several significant flaws with the Commission's argument.

First, in direct and inherent contradiction to this position, throughout the administrative proceeding, the Commission has argued that the affirmative defenses which the Plaintiffs have asserted therein are not related to and are tangential or collateral to that proceeding. (*See* SEC 1st Mot. Strike (6/7/2012) at 1-2 ("Fourteen of the 29 affirmative defenses" which the Commission sought to have stricken in the Administrative Action "seek to estop the Division from prevailing in this action due to various alleged biases and misdeeds that also are irrelevant

to determining the allegations in the OIP against these respondents."); at 4 n.5 ("The 'Preliminary Statement'" which the Commission sought to have stricken from the Plaintiff's answer in the administrative action "raises the same themes which dominate a Complaint against the Commission filed by the Respondents in United States District Court on June 6, 2012."); at 5-6 (same and adding "None of the issues in the [Preliminary Statement] are relevant to the charges in the OIP") (Ex. A); *see also* SEC Ry. re 1st Mot. Strike (6/20/12) at 1-2 ("[T]he Respondents' preliminary statement includes no information relevant to the allegations set forth in the OIP," and "simply [has] nothing to do with" the allegations in the OIP) (Ex. B); SEC Renewed Mot. Strike at 2 ("The eleven challenged affirmative defenses concern collateral and irrelevant matters[.]"); at 5 ("A motion to strike an affirmative defense should be granted, when, as here, the affirmative defense is irrelevant to merits of the claims[.]") (Ex. C (internal exs. omitted)).) Notably and most recently, in a September 24, 2012 filing in the administrative proceeding, the Commission took the position that spending time considering certain of Plaintiff's affirmative defenses was "wasteful," and apart from "trying the OIP on its merits." (*See* Division of Enforcement's Notice Regarding Respondents' "Motion for Reconsideration or Certification for Interlocutory Review," dated September 24, 2012 (Ex. D).)

The Commission seeks "heads I win, tails you lose" justice. It is contradictory and disingenuous for the Commission to argue to this Court that the matters alleged in the Complaint are *not* collateral to the administrative proceeding, when it aids its argument seeking dismissal of this; and *are* collateral to that proceeding when it argues to the ALJ that Egan-Jones's affirmative defenses should be stricken.

Second, the Commission has at every conceivable opportunity attempted to stymie and frustrate the Plaintiffs' ability to assert, obtain and present evidence in support of their

affirmative defenses at the upcoming administrative hearing.[2] The administrative proceeding commenced over five months ago, yet the action has not yet made it past the pleading stage due to the Commission's barrage of pleadings-related motions. The Commission first moved in June 2012 to strike the entire preliminary statement in Plaintiff's answer and eighteen of the twenty-nine affirmative defenses asserted therein. The Commission then in July 23, 2012, pressed Plaintiffs to provide a more definite statement of their remaining affirmative defenses. *See* Commission's Motion for a More Definite Statement, dated July 23, 2012. The ALJ ruled on the request—identifying ten affirmative defenses he deemed to require additional details. (*See* ALJ's Order dated August 8, 2012 (Ex. E).) Plaintiffs complied in a 23-page filing, expanding each of the affirmative defenses challenged, providing in painstaking detail the facts known to Plaintiffs and basis in the case law for the affirmative defense pled. But the Commission still did not relent; on August 27, 2012, it filed yet another motion to strike the remaining affirmative defenses, including an attack on one affirmative defense for which the ALJ did not even require Plaintiffs to provide more details. In sum, over the course of the administrative proceeding, the Commission has sought on three occasions to challenge and remove from the pleadings the very affirmative defenses that raise the issues for which the relief requested in this Complaint is necessary.

Third, the Commission's attempt to couch affirmative defenses as being on equal footing with the Plaintiff's causes of action in this action is unsuccessful. Here, Plaintiffs seek affirmative and injunctive relief. Plaintiffs cannot commence a lawsuit and assert claims in an administrative proceeding before the Commission; the Securities Exchange Act of 1934

[2] In fact, the Commission tried to prevent Plaintiffs from bringing this lawsuit by withholding *mandatory* discovery for almost six weeks because of Plaintiffs' transparency to the administrative forum that they were planning to bring this action.

("Exchange Act") confers the right to do so only on the Commission itself. *See* 15 U.S.C. § 78ac. Thus, parties like Plaintiffs who are constitutionally aggrieved by actions of the Commission are not provided with an independent opportunity to file and assert affirmative claims with the Commission. To add insult to injury, the Commission's Rules of Practice do not even allow respondents hauled before the Commission to do the next best thing—assert counterclaims, an opportunity which is allowed for explicitly in federal courts. *See* Fed. R. Civ. P. 13.

Section 78u(g) of the Exchange Act provides:

> Notwithstanding the provisions of section 1407(a) of Title 28, or any other provision of law, no action for equitable relief instituted by the Commission pursuant to the securities laws shall be consolidated or coordinated with other actions not brought by the Commission, even though such other actions may involve common questions of fact, unless such consolidation is consented to by the Commission.

"The purpose of Section 78u(g) is to ensure speedy resolution of SEC enforcement actions," *S.E.C. v. McCaskey*, 56 F. Supp. 2d 323, 325 (S.D.N.Y. 1999) (citation omitted), and section 78u(g) has been routinely employed to dismiss third-party complaints and counterclaims. *Id.; see S.E.C. v. Better Life Club of Am.,* 995 F. Supp. 167, 179-80 (D.D.C. 1998). Simply, "[t]he SEC's Rules of Practice do not permit counterclaims against the SEC." *Gupta v. S.E.C.*, 796 F. Supp. 2d at 513-14 (citing *In re Feldman*, 1994 WL 23256, at *2 (SEC Admin. Proc. Jan. 14, 1994).)

This is a significant distinction. Counterclaims, which Plaintiffs are not permitted to assert in the administrative proceeding, and affirmative defenses, which they are permitted to assert, "serve vastly different purposes." S*ee, e.g., Microsoft Corp. v. Motorola, Inc.*, No. C10-1823JLR, 2012 WL 395734, at *4 (W.D. Wash. Feb. 6, 2012). "An affirmative defense is the assertion of facts and arguments that, if true, will defeat the plaintiff's claim. Different from an

affirmative defense, a counterclaim is a claim for affirmative relief asserted against the plaintiff." *Agri-Best Holdings, v. Sonoma Cattle Exch.*, No. 10 C 6976, 2011 WL 2039534, *2 (N.D.Ill. May 24, 2011). Through an affirmative defense, a party seeks to bar another party's claims; even if successful on the affirmative defense, the party will receive no relief besides dismissal of its adversary's claims. On the contrary, through counterclaims, a party can seek, *inter alia*, declaratory and injunctive relief.

In sum, the affirmative defenses that Plaintiffs have asserted in the administrative proceeding are no substitute for the claims for affirmative relief they pursue in this Court.

B. Jurisdiction In This Court Is Proper Because The Commission Has Failed To Establish Expertise In The Claims Asserted And Relief Sought By Plaintiffs

The third prong of the analysis set out by *Free Enter. Fund* and *Thunder Basin Coal Co.* is whether the claims asserted and relief sought is within the agency's expertise. The Commission fails to establish any such expertise in support of its motion to dismiss. Additionally, the ALJ's error of law in a recent decision to strike Plaintiffs' selective prosecution affirmative defenses, an error prompted by the Commission's erroneous legal submission, is solid proof of why these issues belong before an Article III court.

The Commission attempts to illustrate its institutional competence in adjudicating the types of constitutional claims by string-citing past decisions. (SEC Mem. at 4-5 ("During the course of administrative proceedings and hearings, both the ALJs and the Commission routinely rule on a wide variety of legal issues, including affirmative defenses raising claims of bias, First Amendment issues, equal protection violations, retroactive application of statutory provisions, and allegations of due process violations.").)

However, on close examination, the cases upon which the Commission relies prove little as the cases cited and detailed below are past decisions that the Commission cherry-picked from

its own archives spanning approximately 40 years.

First Amendment issues are at the very heart of this dispute. Plaintiffs have alleged that the Commission has retaliated against them throughout the NRSRO application and examination process because they have been (and continue to be) outspoken critics of the large, issuer-paid ratings agencies, a business model which the Commission has perpetuated and favors. Plaintiffs have also alleged that the Commission has improperly questioned the substance of their ratings, and that the filing of the administrative action was an act of selective prosecution and the latest in a litany of disproportional and improperly motivated actions towards Plaintiffs, all with an aim of retaliating against them for their protected speech and to silence their voice in the ratings agency marketplace. (Compl. ¶¶ 16-20 (detailing Plaintiffs' criticism of the large issuer-paid ratings agencies before Congress); ¶¶ 26, 117, 121, 151, 153, 177 (detailing Commission's impermissible inquiries into certain of Plaintiffs' ratings); ¶¶ 188-94 (setting forth elements of Plaintiffs' First Amendment infringement, retaliation and selective prosecution claims).

The Commission cites *one* decision from 15 years ago as evidence of its expertise and capability of adjudicating First Amendment claims. (SEC Mem. at 6 n.22 (citing *In re Padgett*, 52 S.E.C. 1257 (Mar. 20, 1997), 1997 SEC LEXIS 634, at *24).) In that decision, the entirety of the treatment of the First Amendment argument asserted by respondent is in a single footnote in a 31-page opinion.

Another central issue raised by the Complaint is that Plaintiffs' due process rights will not be adequately safeguarded in an administrative proceeding that vests oversight and appellate review with the Commission. This is because the Commission has exhibited significant institutional bias against Egan-Jones in its disparate treatment of the firm, while subjecting Egan-Jones to a veritable onslaught of resource-draining investigations and improper second-guessing

of its objectively sound and prescient ratings, culminating in the SEC's filing of the administrative proceeding based only on alleged deficiencies and interpretive differences in application documents. (Compl. ¶¶ 175-76.)

The Commission cites three cases for its purported expertise in due process claims. (SEC Mem. at 17 n.25 (citing *In re Dearlove*, 92 S.E.C. Docket 1427, (Jan. 31, 2008), 2008 SEC LEXIS 223 at *123-24, *In re Lexington Resources*, (Jun. 5, 2009), 2009 SEC LEXIS 2057 at *6-*8, and *In re Trautman*, 98 S.E.C. Docket 175 (Dec. 15, 2009), 2009 SEC LEXIS 4173 at *69 n.69.) The *Trautman* decision offers one footnote of due process analysis in its 45-page decision. In *Lexington Resources*, the opinion offers only two paragraphs in the body of the 21-page decision. The Commission does in one opinion—*Dearlove*—deal with a due process claim in a more than perfunctory way; the respondent's claim, though, was denied.

A theme through the entire Complaint is that Plaintiffs' Equal Protection rights have been violated as a result of the Commission's disparate treatment of them as compared with the large issuer-paid NRSROs. In support of those claims, Plaintiffs explained that despite their critically acclaimed prescient ratings, the accuracy of which remains unchallenged (Compl. ¶¶ 21-42), the large issuer-paid firms, whose ratings-related errors were historic and misrepresentations were brazen, were never the subject of an administrative proceeding seeking suspension of their license to issue ratings in any rating category (*id.* ¶¶ 60-93), which in turn is evidence of disparate treatment of Plaintiffs. (*Id.* ¶¶ 186-87.)

For their purported expertise in dealing with Equal Protection claims, central to Plaintiffs' claims for relief, the Commission cites two decisions—one of which reaches back nearly 40 years. (SEC Mem. at 6 n.23 (citing *In re Indigenous Global Dev. Corp.* (Jan. 12, 2007), 2007 SEC LEXIS 47 at *10 and *In re Koss Sec. Corp. et al*, (Dec. 12, 1973), 1973 SEC

LEXIS 3493 at *34.) In *Indigenous Global*, the Commission dealt with and dismissed in three paragraphs a claim of selective prosecution similar to which the Plaintiffs are pursuing in this action. In the ancient *Koss Securities* decision, the Commission dispenses with the Equal Protection claims raised in two paragraphs of a 35-page decision.

The Commission offers two cases in support of its supposed expertise in interpreting Congressional intent to determine retroactive application of statutes. (SEC Mem. at 6 n.24, 30 n.113-14.) Yet in one case, *In re Canady*, the statute expressly stated that retroactive application was not forbidden; thus no searching interpretation was needed. In the other case, *In re Castel Securities Corp.*, the ALJ even cited the Commission's own lack of expertise with retroactivity issues, noting "[n]either party has directed me to controlling federal or Commission precedent that would dispose of the [retroactivity] issue raised herein, and I have not discovered any."

Likewise, the majority of the very few Commission opinions addressing the retroactivity of Dodd-Frank provisions (and the Commission can point to only one such provision—the Dodd-Frank § 925 "collateral bar" provision) have ruled without providing analysis or citation to other authority with analysis, often appearing as "boilerplate" holdings. *See, e.g., In re Burns*, Exchange Act Rel. No. 66738, 2012 WL 1119224, at *2 (Apr. 4, 2012) (retroactivity of Dodd-Frank "collateral bar" provision); *In re Glasser*, Exchange Act Rel. No. 66858, 2012 WL 1422282, at *3 & n.2 (April 25, 2012) (same, boilerplate language); *In re Morris*, Exchange Act Rel. No. 67758, 2012 WL 3756972, at *3 (Aug. 30, 2012)(same, boilerplate language). Very few have engaged in any kind of analysis, which shows that this is not an issue regularly faced by the Commission. *See, e.g., In re Lawton*, Admin. Pro. Rel. No. 419, 2011 WL 1621014, at *3-4 (Apr. 29, 2011) (noting that "Neither the Division nor the pro se litigant addressed the issue" of retroactivity). Other opinions have simply noted the lack of retroactive application by

other ALJ's without performing the retroactivity analysis, or citing to those cases. *See In re Richey*, Exchange Act Rel. No. 67925, 2012 WL 4421782, at *2 n.1 (Sept. 25, 2012) (citing two *non-Dodd-Frank* court of appeals cases for the proposition that "[n]either the Commission nor the courts have approved such retroactive application of" Dodd-Frank's "collateral bar" provisions); *In re Campbell*, Exchange Act Rel. No. 67770, 2012 WL 3775897, at *2 n.1 (Aug. 31, 2012) (same, boilerplate language). Just because a person has changed a light-bulb, does not make him an electrician. Boilerplate opinions on issues outside of the Commission's expertise are not "prior rulings that show expertise" where those opinions plainly fail to provide analysis, or even citation to other authority with analysis. If anything, this shows a lack of expertise.

But the most potent evidence of a lack of agency expertise is the recent decision in the extant SEC administrative case against Egan-Jones. In a September 14, 2012 Order, the ALJ struck several of Plaintiffs' affirmative defenses. (*See* Order of Sept. 14, 2012 (Ex. F).) Indispensable to its decision to do so was the following:

> The Division argues that subscriber-paid NRSROs are not a protected class for purposes of equal protection analysis. The case law cited by the Division, particularly *American Electric*, is persuasive on this point. Respondents make little effort to rebut this argument.
>
> Instead, Respondents assert that membership in a protected class is not necessary to prove a selective prosecution defense. Opposition, pp. 14-15. This is beside the point. Respondents have asserted as the basis of defenses 14-18 that they are members of a class, and that class is not constitutionally protected. Accordingly, there is no set of facts that they can prove, consistent with these defenses that can provide them relief. These defenses will be stricken.

Id. However, and as explained by Plaintiffs in a significant substantive motion for reconsideration of the September 14th decision: (1) a party need not be a member of a protected or suspect class to assert an equal protection claim; (2) whether a party claiming an equal protection violation is a member of a protected class affects only the level of scrutiny of the

challenged governmental action, not whether the party has a claim; (3) *American Electric*, on which the Commission and the ALJ relied, was a non-controlling district decision not cited by any other court which misapprehended the controlling law of its own Circuit and the Supreme Court; and (4) selective prosecution based on protected First Amendment activity requires identification of those similarly situated who have not been prosecuted – here, the large issuer-paid ratings agencies of which group Plaintiffs are not part. The basis for striking Plaintiffs' selective prosecution affirmative defenses rested on a misapprehension of hornbook constitutional law pressed by the Commission in its briefs and adopted by the ALJ, concerning the very Equal Protection and First Amendment concepts with which the Commission has essentially admitted virtually no past experience.

V. PLAINTIFFS ARE NOT BARRED FROM SEEKING REVIEW OF THE COMMISSION'S ORDER INSTITUTING THE ADMINISTRATIVE PROCEEDING BY 5 U.S.C. § 704

The Commission argues that, pursuant to 5 U.S.C. § 704, Mr. Egan and Egan-Jones are barred from seeking review of the order instituting the administrative proceeding because it is not a final agency action. (SEC Mem. at 18.) This argument is misplaced. Section 704 of the APA states, among other things, that "[a]gency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review." 5 U.S.C. § 704. *See Md. Dep't of Human Res. v. Dep't of Health & Human Servs.,* 763 F.2d 1441, 1445 n.1 (D.C. Cir. 1985) ("The Supreme Court has clearly indicated that the Administrative Procedure Act itself … does supply a generic cause of action in favor of persons aggrieved by agency action."). In *Trudeau v. FTC*, 456 F.3d 178 (D.C. Cir. 2006), the court addressed whether the finality requirement contained in § 704 of the APA was jurisdictional. The court held that the APA "neither confers nor restricts subject-matter jurisdiction permitting federal judicial review of agency action" and that the Act's finality requirement was not

jurisdictional "[b]ecause § 704's declaration that final agency action is 'subject to judicial review' is not a grant of jurisdiction" and even if the court were to "infer by negative implication that agency conduct not amounting to final agency action is not 'reviewable,' that inference would not deprive a federal court of any jurisdiction it otherwise has." 456 F.3d at 183-84. *See also Air Courier Conf. v. Am. Postal Workers Union,* 498 U.S. 517, 523 n.3 (1991) ("The judicial review provisions of the APA are not jurisdictional"); *Reliable Automatic Sprinkler Co. v. Consumer Prod. Safety Comm'n,* 324 F.3d 726, 731 (D.C. Cir. 2003) (making clear that where "judicial review is sought under the APA rather than a particular statute prescribing judicial review, the requirement of final agency action is not jurisdictional"); *Center for Auto Safety v. NHTSA,* 452 F.3d 798, 805 (D.C. Cir. 2006) (citing *Reliable* and affirming that the APA's final agency action requirement is not jurisdictional).

Although it is true that the APA does not provide review for everything done by an administrative agency, *see, e.g., Hearst Radio v. FCC*, 167 F.2d 225 (D.C. Cir. 1948), the fact that an agency has not issued an order or command "does not mean that the step by which it initiated a procedure, or informal activity, leading up to the exercise of its powers may be relegated to the area of mere unreviewable 'suggestion.'" *Indep. Broker-Dealers' Ass'n*, 442 F.2d at 139 (sustaining jurisdiction in district court to review validity of Commission's actions on ground that Commission's involvement constitutes 'agency action' within meaning of Administrative Procedure Act). "The ultimate test of reviewability is not to be found in an over-refined technique, but in the need of the review to protect from the irreparable injury threatened" in a situation where administrative rulings or actions "attach legal consequences to action[s] taken in advance of other hearings and adjudications that may follow[.]" *CBS v. S.E.C.*, 316 U.S. 407, 425 (1942).

VI. THE REQUESTS FOR DECLARATORY JUDGMENT AND INJUNCTIVE RELIEF ARE PROPERLY BEFORE THIS COURT

The Commission's contention that the Plaintiffs do not state claims for declaratory judgment or injunctive relief is essentially a retread of other erroneous arguments.

The Commission's argument that Plaintiffs have an adequate remedy at law and thus are not to entitled equitable relief is two-fold: (1) Plaintiffs have raised in the administrative proceeding all the defenses they seek to raise here; and (2) they can seek review in a court of appeals of a Commission decision. As to the Commission's first contention, as discussed above, there is a significant difference between affirmative defenses and causes of action requesting affirmative relief, and the SEC moved to strike and the ALJ struck most of the affirmative defenses *from the pleadings*. As to its second position, as discussed above in the analysis of the *Thunder Basin* and *Free Enterprise* factors, forcing Plaintiffs to wait until the petition for review process to finally obtain an audience with a federal court forecloses any meaningful review.

The Commission's argument that the plaintiffs have not pled irreparable harm is similarly incorrect. The Plaintiffs alleged throughout the Complaint that the action already taken by the Commission has been motivated to diminish Plaintiffs' voice in the credit ratings market, and that those ratings and Plaintiff's criticism of the large issuer-paid model are protected First Amendment activity. Part of the relief that the Commission may seek to obtain in the administrative proceeding, the very existence of which is challenged as a current infringement on Plaintiffs' Due Process, Equal Protection and First Amendment rights, is a revocation of Plaintiffs' license to rate sovereign debt and asset-backed securities. The Commission's pre-occupation with, selective prosecution of, and constant challenges to the ratings issued by Plaintiffs infringe significantly on the First Amendment rights of Plaintiffs by attempting to diminish and marginalize Egan-Jones to the advantage of the large, issuer-paid firms.

Additionally, the Commission's application and enforcement of Rule 17(g) promulgated under the Exchange Act and the other rules pursuant to which the administrative proceeding has been brought have a chilling effect on the constitutionally protected expression of Plaintiffs, which includes not only their rating activity but their criticism of the Commission and the large firm model which its perpetuates. "The loss of First Amendment freedoms, for even minimal periods of time, unquestionably constitutes irreparable injury." *Elrod v. Burns*, 427 U.S. 347, 373 (1976); 11A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Fed. Prac. & Proc.* § 2948.1 (2d ed. 1995) ("When an alleged deprivation of a constitutional right is involved, most courts hold that no further showing of irreparable injury is necessary.").

The Commission argues that there is no basis for declaratory relief as the Declaratory Judgment Act presupposes independent existence of subject-matter jurisdiction. However, as Plaintiffs have demonstrated at length, this Court has subject-matter jurisdiction pursuant to the APA, 28 U.S.C. § 1331 and the Supreme Court's decisions in *Free Enterprise* and *Thunder Basin*.

VII. THE DIVISION OF ENFORCEMENT ACTED CONTRARY TO FEDERAL STATUTE BY DELEGATING AUTHORITY TO CONDUCT THE INVESTIGATION

The Commission, in its Motion to Dismiss, did not address Egan-Jones's and Mr. Egan's allegations in paragraphs 136 through 142 of the Complaint, which set forth expressly how the Commission violated the language and intent of section 21(b) of the Exchange Act and violated the Administrative Procedure Act in the delegation of authority to conduct the investigation. Because the Commission did not raise the issue in its Motion to Dismiss—notwithstanding that this goes directly to one form of relief requested—Egan-Jones and Mr. Egan do not brief the issue here. In short, so this issue about how a federal agency conducts regulatory investigations and Plaintiffs' assertion that the Commission has unilaterally reformulated its own authority and

removed Congressionally imposed checks-and-balances for conducting investigations in recent years, Egan-Jones and Mr. Egan succinctly restate the issue raised in the seven referenced paragraphs of the Complaint.

Section 21(b) of the Exchange Act provides expressly that "[f]or the purpose of any such investigation [as permitted under section 21(a) of the Exchange Act], or any other proceeding under this title, any member of the Commission or *any officer designated by it* is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda or other records which the Commission deems relevant or material to the inquiry." (Compl. ¶137(emphasis added).) Congress, in and through section 21(b) of the Exchange Act, delegated expressly, but only to the Commission and directly, the power to designate officers of its investigations. (*Id.* ¶138.) Congress did not delegate to the Commission the ability to, in turn, delegate to any of its staff, let alone any staff member of Enforcement, the ability to designate, or let alone sub-delegate further, officers of the Commission for the purpose of an investigation. (*Id.* ¶138.) Effective August 11, 2009, the Commission amended its rules to delegate authority to the Director of Enforcement to issue formal orders of investigation. (*Id.* ¶139.) The Commission, in amending its rule delegating this authority, reported that it found, "in accordance with the Administrative Procedure Act (APA) (5 U.S.C. §553(b)(3)(A)), that this amendment relates solely to agency organization, procedure or practice." (*Id.* ¶139.) In fact, the amendment of the rule to delegate authority to the Director of Enforcement violates the express language of section 21(b) of the Exchange Act, violates the APA and removed a critical oversight responsibility imposed by Congress on the Commission in the supervision of Enforcement investigations. (*Id.* ¶139.) The real-world effect is obvious: if an SEC staff member wants agency authority to issue

subpoenas to conduct an investigation or to expand the scope of an investigation, that staff member no longer is accountable directly to the Commission.

Congress, in granting authority for the SEC to conduct investigations, a right that Plaintiffs do not challenge, undoubtedly did not contemplate expansion of authority through speech-making. In a speech delivered on August 5, 2009, the Director of Enforcement stated: "I am announcing tonight that the Commission has approved, subject to certain exceptions, an order that delegates to the Division [of Enforcement] Director the authority to issue formal orders of investigation, with their accompanying subpoena power. I in turn intend to delegate that authority to senior officers throughout the Division." (Compl. ¶140 (quoting Remarks [of the Director of the Division of Enforcement] Before the New York City Bar: My First 100 Days as Director of Enforcement, New York (Aug. 5, 2009), available at http://www.sec.gov/news/speech/2009/spch080509rk.htm.) Congress did not authorize and the Commission did not have authority to authorize the Director of Enforcement to delegate authority to issue formal orders of investigation. (Compl. ¶ 140.) The Commission did not address this issue in its Motion to Dismiss.

The consequences and conclusions set forth in paragraph 142 of the Complaint completes the distillation of this significant issue. Because the Commission violated express Congressional intent as set forth in section 21(b) of the Exchange Act and improperly delegated authority to the Director of Enforcement to issue formal orders of investigation, no authority exists pursuant to which the Director of Enforcement could in turn have delegated "that authority to senior officers throughout the Division [of Enforcement]." (Compl. ¶ 142.) Moreover, no authority exists pursuant to which the Director of Enforcement or any "senior officers" of Enforcement may designate officers of different Divisions of the Commission as officers on a formal order of

investigation. (*Id.* ¶ 142.) Egan-Jones and Mr. Egan are not arguing that the Commission does not or should not have authority to conduct investigations; instead, it is simply Congress that established that the Commission—that is the Commission alone—should decide what and whom to investigate. Accordingly, the Commission violated the Administrative Procedure Act, 5 U.S.C. §302(b) and §§551 *et seq.*, by the delegation and further sub-delegation of authority to issue formal orders of investigation. (Compl. ¶ 142.) Moreover, the Commission's failure to provide notice of the proposed rulemaking and opportunities for public participation, which directly impacted all parties subject to an investigation under section 21(a) of the Exchange Act, also violated the APA. (Compl. ¶ 142.) As this issue is beyond the Motion to Dismiss, Egan-Jones and Mr. Egan request respectfully that this Court require the Commission to Answer these allegations and for discovery to proceed as to this issue.

CONCLUSION

For all of these reasons, Plaintiffs respectfully requested that the Court deny the Commission's Motion in its entirety.

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Respectfully submitted,

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