UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

EGAN-JONES RATING COMPANY and SEAN EGAN Plaintiffs,	:	12-cv-00920 (ABJ)
v.	:	
UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Defendant.	:	

REPLY TO OPPOSITION TO THE SEC'S MOTION TO DISMISS THE COMPLAINT

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PRELIMINARY STATEMENT

Plaintiffs begin their opposition by admitting that their Complaint seeks "forms of relief that, to [Plaintiffs'] knowledge, have never been sought from a federal court."[1] Indeed, Plaintiffs ask this Court to "remove" a pending SEC administrative proceeding[2] (the "Administrative Proceeding") to this Court, without citing any statutory or other authority for removal of an agency administrative proceeding to federal court. Plaintiffs appear to assert that this Court has jurisdiction because the SEC allegedly instituted the Administrative Proceeding – which is premised on allegations that Plaintiffs have violated the federal securities laws – in response to their criticisms about the Commission's regulation of credit rating agencies.[3] But Plaintiffs' claims are not limited to their allegations of bias and Plaintiffs cannot disguise their actual goal: to obtain interlocutory review of an ongoing administrative proceeding. [4]

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[1] Pl. Mem. at 1.

[2] *In the Matter of Egan Jones Ratings Co.* The Administrative Proceeding is in the discovery phase, and the hearing is scheduled to commence on November 26, 2012.

[3] Pl. Mem. at 10.

[4] Virtually all of the relief sought in the Complaint focuses on the Administrative Proceeding. Although the Complaint goes on at length about numerous background topics, the core of the allegations centers on the Administrative Proceeding. Similarly, Plaintiffs' Memorandum in Opposition focuses upon, and attaches six exhibits all of which are from, the Administrative Proceeding. And Plaintiffs complain about rulings of the Administrative Law Judge ("ALJ") in the Administrative Proceeding.

As we discussed in our opening brief, sovereign immunity bars this action, and this Court should not create new law overturning long-established precedent to afford Plaintiffs an opportunity to obtain interlocutory review of the ongoing SEC proceeding when they can assert their bias arguments as an affirmative defense in the Administrative Proceeding and obtain plenary review of any final Commission order in a court of appeals.

ARGUMENT

I) APA Review is Only Available for Final Orders, or Orders for Which There is No Adequate Legal Remedy.

Plaintiffs have failed to establish that their claim falls within the limited waiver of sovereign immunity in the Administrative Procedure Act ("APA")[5] for final orders, or orders for which there is no adequate remedy of law.

A) APA Section 702 is limited by other statutes.

Plaintiffs quote part of APA Section 702 on page 5 of their Memorandum, setting forth 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." Section 702 does provide a limited waiver of sovereign immunity. But Section 702 goes on to state that "*Nothing herein . . . affects other limitations on judicial review* or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable

[5] 5 U.S.C. § 701 *et seq*.

ground."[6] As we explained in our opening Memorandum, APA Section 704 provides one such limitation: Section 702 only provides jurisdiction for review of final agency orders for which there is no other adequate remedy. And, as we further noted, Section 25(a) provides an adequate remedy: review in a court of appeals at the conclusion of the Administrative Proceeding – if necessary. *See Stone v. Dep't. of Treas.*, (D.D.C. May 9, 2012), 2012 U.S. Dist. LEXIS 64727 at *8-*9 (Jackson, J.).

B) APA Section 704 dictates that interim orders are reviewed when final orders are reviewed.

Plaintiffs attempt to bypass the limits of APA Section 704[7] and Exchange Act Section 25(a)[8] by arguing that they are not seeking review of a final order, and those provisions only impose limits on review of final orders. Plaintiffs' position defies logic. In limiting judicial review under the APA to final orders, Congress did not mean to allow review of any and all interim orders in any court at any time, as Plaintiffs apparently contend. On the contrary, the text of APA Section 704 explains when interim orders such as the order instituting the Administrative Proceeding and the ALJ's rulings in the proceeding are to be reviewed: "A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action."[9]

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[6] 5 U.S.C. § 702 (emphasis supplied).

[7] 5 U.S.C. § 704.

[8] 15 U.S.C. § 78y(a).

[9] 5 U.S.C. § 704.

C) This case is controlled by *FTC v. Standard Oil Co. of Cal.*

The facts and procedural posture of this case directly parallel *FTC v. Standard Oil Co. of Cal.*,[10] in which the Supreme Court rejected an attempt to seek interlocutory review in a district court of an FTC order instituting an administrative proceeding. Plaintiffs attempt to distinguish *Standard Oil* on the basis that the plaintiff in that case was attempting to challenge the facts in the administrative proceeding, whereas Egan and Egan-Jones purportedly are "challeng[ing] the Commission's unfair and arbitrary treatment of Plaintiffs leading up to and including the filing of the administrative proceeding."[11]

But Plaintiffs' claims are the precise type of challenge attempted and rejected in *Standard Oil*. There the plaintiff sought district court review of the FTC's decision to institute administrative proceedings on the grounds that the FTC had initiated the proceedings due to bias against oil companies following the gas crisis, and without conducting a proper investigation:[12]

> [Plaintiff] Socal filed a complaint against the Commission in the District Court . . . alleging that the Commission had issued its complaint without having "reason to believe" that Socal was violating the Act. Socal sought an order declaring that the issuance of the complaint was unlawful and requiring that the complaint be withdrawn. . . . In support of its allegation and request, Socal recited a series of events that preceded the issuance of the complaint and several events that followed. . . . The gist of Socal's recitation of events preceding the issuance of the complaint is that political pressure for a

[10] 449 U.S. 232 (1980).

[11] Pl. Mem. at 10.

[12] 449 U.S. at 235.

> public explanation of the gasoline shortages of 1973 forced the Commission to issue a complaint against the major oil companies despite insufficient investigation.[13]

Here, Egan and Egan-Jones are alleging that the SEC improperly instituted administrative proceedings due to its alleged bias following a purportedly flawed investigation. And, like the plaintiffs in *Standard Oil*, Egan and Egan-Jones cannot seek relief in federal court unless and until the SEC issues a final order.

Moreover, the Supreme Court in *Standard Oil* specifically rejected the argument that district court jurisdiction was necessary because the rules of procedure applicable to the administrative proceeding in that case might not allow the *Standard Oil* litigants to gather evidence to support their claims:

> We are not persuaded by this speculation. The Act expressly authorizes a court of appeals to order that the Commission take additional evidence. Thus, a record which would be inadequate for review of alleged unlawfulness in the issuance of a complaint can be made adequate.[14]

The Court continued, further explaining that interlocutory review of an order initiating administrative proceedings was not needed because such interim orders were reviewable when a final order resulted.

> We also note that the APA specifically provides that a "preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency

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[13] *Id.* (notes omitted).

[14] 449 U.S. at 244-245 (notes and citations and quotations omitted). The Supreme Court was referring to gathering additional evidence pursuant to 15 U.S.C. § 45(c), a provision governing review of Federal Trade Commission orders. 15 U.S.C. § 78y(a)(5) is an almost identical provision governing review of SEC orders.

> action," and that the APA also empowers a court of appeals to "hold unlawful and set aside agency action . . . found to be . . . without observance of procedure required by law." [15]

Thus, this case is directly controlled by *Standard Oil*.

Plaintiffs cite *Trudeau v. FTC* [16] in arguing that section 702 of the APA waives sovereign immunity, and section 704's finality requirement is not jurisdictional. But *Trudeau* emphasized that absent final agency action, the plaintiff could not maintain a cause of action under the APA.[17] *Trudeau* does not authorize district courts to conduct interlocutory reviews of ongoing agency administrative proceedings.

II) Plaintiffs Do Not Meet the *Thunder Basin / Free Enterprise* Test.

As Plaintiffs cannot establish jurisdiction that their claim falls within the limited waiver of sovereign immunity in the APA, to obtain district court review of a non-final SEC order Plaintiffs must satisfy the Supreme Court's stringent *Free*

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[15] 449 U.S. at 245 (quoting 5 U.S.C. § 704 and § 706).

[16] 456 F.3d 178 (D.C. Cir. 2006). In *Trudeau*, plaintiff contended that an FTC press release contained intentional misrepresentations and exceeded the FTC's authority. No FTC administrative proceeding was pending or available for Trudeau to challenge the press release. Both the district court and the court of appeals agreed that the differences between the press release and the underlying settlement agreement were "minor or illusory," so that Trudeau's complaint was insufficient to state a claim. 456 F.3d at 197. The D.C. Circuit has regarded a failure to satisfy APA requirements as, alternatively, a lack of subject matter jurisdiction or as a failure to state a claim. *See* Opening Mem. at 15, n. 60.

[17] 456 F.3d at 188-89 ("the absence of final agency action . . . would cost Trudeau his APA cause of action").

Enterprise v. PCAOB[18] and *Thunder Basin Coal Co. v. Reich*[19] test by making the following three showings: 1) a lack of jurisdiction would foreclose all meaningful judicial review; 2) the suit is wholly collateral to the statute's review provisions; and 3) the claims are outside the agency's expertise.[20] But here, Plaintiffs fail to meet any prong.

A) Plaintiffs can Obtain Meaningful review as a Court of Appeals Could Grant all the Relief they seek.

Egan and Egan-Jones assert that judicial review of a final Commission order pursuant to Exchange Act Section 25(a) would not be meaningful because they might have to wait before receiving it. Potential delay does not render appellate review meaningless. As we explained in our Opening Memorandum, sanctions against Plaintiffs, if there are any, will not be imposed until at least after the Commission has had the opportunity to review the ALJ initial decision, and could be further stayed until a court of appeals hears a petition for review. Further, the Supreme Court in *Thunder Basin* found that eventual review in a court of appeals satisfied the meaningful judicial review prong.[21] And this review might not be necessary as the ALJ or the Commission could rule in favor of Egan and Egan-Jones in the Administrative Proceeding.

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[18] 130 S. Ct. 3138 (2010).

[19] 510 U.S. 200 (1994).

[20] 510 U.S. at 212-213; 130 S. Ct. at 3150.

[21] 510 U.S. at 215.

B) The Complaint is not wholly collateral because plaintiffs are challenging an administrative proceeding which is part of the statutory review scheme.

Plaintiffs make two critical errors in claiming that their claims are not wholly collateral. First, they incorrectly assert that they only need to show that their claims are collateral to the facts alleged in the order instituting the Administrative Proceeding,[22] when in fact the Supreme Court has said that the claims need to be "wholly collateral to a statute's review provision."[23] The distinction is important. *Free Enterprise* review is not available whenever a respondent in an agency administrative proceeding asserts a claim, such as bias, that might be collateral to the core allegations in the proceeding. It is available only where the allegation is wholly collateral to the statutory review provisions.

The allegations of the *Free Enterprise* plaintiffs were wholly collateral because the only way to have them reviewed would have been to incur an unrelated violation to get into a forum from which review could be sought. Likewise, in *Thunder Basin* the Court pointed to *Matthews v. Eldridge*[24] as an example of an entirely collateral claim, because the litigant there sought to bring a facial due process challenge to "the constitutional validity of the administrative procedures established" for determining whether disability payments should be terminated.[25]

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[22] Pl. Mem. at 17.

[23] 130 S. Ct. at 3150 (emphasis supplied).

[24] 424 U.S. 319 (1976).

[25] *Id.* at 324-325.

Here, Plaintiffs concede that SEC proceedings typically afford due process, and complain about actions specific to this case.

> While administrative agencies have provided and do provide Due Process in vast situations, in 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.[26]

Such a fact-specific challenge to an individual administrative proceeding is not collateral to the statutory review scheme for reviewing final SEC orders resulting from administrative proceedings. The same is true for Plaintiffs' allegations of bias by the SEC,[27] a claim that they can make to the SEC and then ask a court of appeals to review – if necessary.

Plaintiffs' second critical mistake in claiming their suit is wholly collateral is failing to understand the distinction between the five Presidentially-appointed Commissioners of the Securities and Exchange Commission, and the SEC's Division of Enforcement, which is one of several operating divisions and offices within the

[26] Complaint ¶176 (emphasis supplied).

[27] *See* Pl. Mem. at 14-17.

SEC.[28] Numerous times in their papers, the Plaintiffs assert that in the Administrative Proceeding the "Commission" has taken some step, or made some argument, that is in fact the action or argument of only the Division of Enforcement. For example, Plaintiffs assert that "The Commission first moved on June 2012 to strike the entire preliminary statement in Plaintiff's [sic] answer and eighteen of the twenty-nine affirmative defenses asserted therein."[29] In fact, it was the Division of Enforcement that made this motion, as is plainly stated in the motion that Plaintiffs attached as Exhibit A to their Memorandum. The ALJ denied the motion, and the Commission has not taken any position on it.[30]

The distinction between the Commission and the Division of Enforcement is critical because in an SEC administrative proceeding the five Commissioners sit as

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[28] The Plaintiffs also allege that prior to the administrative proceeding the SEC violated Exchange Act Section 21(b), 15 U.S.C. § 78u(b), by delegating some authority related to commencing investigations to the Division of Enforcement. Pl. Mem. at 29-32. The SEC properly delegated its authority under Section 21(b) pursuant to explicit congressional authorization in Exchange Act Section 4A: "the Securities and Exchange Commission shall have the authority to delegate, by published order or rule, any of its functions to a division of the Commission, an individual Commissioner, an administrative law judge, or an employee." 15 U.S.C. § 78d-1(a) (emphasis added). *See also* 17 C.F.R. § 200.30-4(a)(13) (delegating authority).

[29] Pl. Mem. at 19 (emphasis supplied).

[30] This memorandum does not address whether any of Egan's and Egan-Jones' substantive allegations regarding retroactivity or constitutional issues fail to state a claim. As Egan and Egan-Jones could raise these claims in the administrative proceeding, the brief does not take a position on those potential claims. This memorandum should not be misconstrued by any of the parties to the administrative proceeding as taking any position on the legal or factual merits of any of the claims or defenses asserted in that administrative proceeding.

an appellate body that reviews the initial decision by the ALJ. The Commission is not prosecuting the Administrative Proceeding, the Division of Enforcement is. The Commission, when reviewing the ALJ's initial decision, could reverse some or all of the orders about which Plaintiffs complain. The Commission can and does rule against the Division of Enforcement when it disagrees with the Division's analysis or arguments.[31]

Plaintiffs also rely on the flawed district court decision in *Gupta v. SEC*,[32] but fail to distinguish meaningfully the subsequent decision of the Second Circuit in *Altman v. SEC*.[33] Although it is true that Altman challenged the SEC's order in district court after it was issued, rather than before, the Second Circuit did not rely on that fact. Instead, it called "well-reasoned" the district court decision

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[31] *See, e.g., In the Matter of James T. Patten*, AP File No. 3-11812 (Nov. 3, 2006) 2006 SEC LEXIS 3175 at *6-*7 (Opinion of the Commission reversing administrative law judge finding that respondent had violated antifraud provisions of the federal securities laws because "we have concluded that the record before us does not establish by a preponderance of the evidence that [the respondent] committed the offenses charged."); *In the Matter of Kevin Hall, CPA et al*, AP File No. 3-12208 (Dec. 14, 2009) 2009 SEC LEXIS 4165 at *42 (Opinion of the Commission affirming ALJ finding that respondents do not engage in improper professional conduct because "we find that the Division [of Enforcement] did not establish that Respondents' conduct with respect to the confirmation procedures in the FY 1999 audit constituted an unreasonable departure from GAAS."); *In the Matter of Scott G. Monson*, AP File No. 3-12429 (Jun 30, 2008) 2008 SEC LEXIS 1503 at *22 (Opinion of the Commission affirming ALJ finding that proceedings should be dismissed because "[u]nder all the circumstances, and based on our de novo review of the record in this case, we have concluded that the record before us does not establish by a preponderance of the evidence that Monson was negligent.")

[32] 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

[33] 687 F.3d 44 (2d Cir. 2012).

emphasizing that Altman, like Egan and Egan-Jones here, was challenging one proceeding before the SEC rather than the existence of an entire agency, as was the case in *Free Enterprise*.[34] For this reason, both the Second Circuit[35] and the district court[36] found that *Altman* failed the *Free Enterprise* / *Thunder Basin* test.

C) Expertise

The expertise the SEC has in addressing the issues raised by Egan and Egan Jones is at least comparable to, if not greater than, the expertise that the Supreme Court found sufficient in *Thunder Basin*. Moreover, in *Thunder Basin*, the Court noted that even where an agency did not have expertise on some issues, the district court still did not have jurisdiction because the agency had expertise on some of the statutes at issue.[37] Thus, even if the Court finds that the SEC lacks expertise on some of the issues that Plaintiffs raise, it should not remove the administrative proceeding to federal court because the SEC can apply its expertise to the central questions in the Administrative Proceeding, all of which concern alleged violations of the federal securities laws. Also, the SEC has the power to grant the substantive relief that Plaintiffs seek. Although it cannot grant declaratory judgment or injunctions, it could dismiss the proceedings against Egan and Egan-Jones, which would have the same practical effect.

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[34] *Id.* at 45; *Altman v. SEC*, 768 F. Supp. 2d 554, 560-561 (S.D.N.Y. 2011).

[35] 687 F.3d at 46.

[36] 768 F. Supp. 2d at 560-561.

[37] 510 U.S. at 214.

II) Plaintiffs Have Not Met Their Burden to Demonstrate Irreparable Harm.

Even if the Court has jurisdiction, it should dismiss the Complaint under Rule 12(b)(6) for failing to state a claim for injunctive or declaratory relief. Plaintiffs have not identified irreparable harm entitling them to an injunction to halt the Administrative Proceeding or remove it to federal court.

Plaintiffs assert that they do not need to show irreparable injury because they are claiming that the Commission is infringing on their right under the First Amendment to criticize the agency.[38] Although Plaintiffs have a First Amendment right to criticize how the agency has performed its mission, that does not mean the SEC may not institute a proceeding to determine if the Plaintiffs have engaged in wrongdoing that is unrelated to their constitutionally protected criticism.

Adopting Plaintiffs' First Amendment argument would mean that no federal agency could ever bring an administrative proceeding against a person or entity that had criticized the agency. Plaintiffs would have this Court rule that anytime a person criticized an agency, and the agency subsequently instituted proceedings against that critic, the critic could ask a district court to enjoin the proceeding. This would unravel the administrative scheme Congress enacted and provide an easy means to frustrate a regulator's attempt to enforce relevant laws and regulations.

If Plaintiffs have a legitimate First Amendment defense, they can present it to the ALJ, who played no role in any of the events preceding the order instituting

[38] Pl. Mem. at 29.

proceedings.[39] If Plaintiffs do not convince the ALJ or the Commission of the validity of their First Amendment defense, they can petition for review by the courts of appeals, who presumably would not turn a blind eye to a substantiated claim that an agency had commenced an administrative proceeding to retaliate against a persons or entities for exercising their right to freedom of expression.

[39] *See* 5 U.S.C. § 554(d)(2) (setting forth that administrative law judges cannot report to or be supervised by an agency's investigative staff and banning anyone who participates in an investigation leading to an administrative proceeding or any factually related investigation from advising on agency's decision).

CONCLUSION

For the reasons stated, the SEC respectfully requests that the Court dismiss the Complaint.

Dated: October 26, 2012
Washington, D.C.

Respectfully submitted,

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