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CTFD. NO. _____

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
July 2, 2002

In the Matter of :
: **ORDER ON MOTION**
ERNST & YOUNG, LLP :
:

The Securities and Exchange Commission ("Commission") instituted this proceeding on May 20, 2002. The Order Instituting Proceedings ("OIP") ends with "By the Commission," the name of the Commission Secretary, and the signature of an Assistant Secretary.

At a prehearing conference on June 6, 2002, we established a procedural schedule and decided that the hearing will begin in Washington, D.C., on September 18, 2002. On June 12, 2002, Ernst & Young, LLP, ("Ernst & Young") answered the OIP. In addition, Ernst & Young filed a Motion For More Definite Statement, a Memorandum in Support of the Motion For More Definite Statement, a Motion For Leave To Seek Summary Disposition, a Motion For Summary Disposition, and a Memorandum in Support of Motion For Summary Disposition.¹

On June 19, 2002, the Commission's Division of Enforcement and Office of the Chief Accountant ("Division and Chief Accountant") filed in opposition to both the Motion For More Definite Statement and Motion For Summary Disposition.

On June 24, 2002, Ernst & Young submitted two Reply Memoranda, one in support of the Motion For More Definite Statement and the other in support of the Motion For Summary Disposition ("Reply").

Motion For Summary Disposition

The Commission is composed of five members. See 17 C.F.R. § 200.10. A single Commissioner authorized the OIP because in May 2002, the Commission had two vacancies, and two members recused themselves from participating in this matter. (Memorandum In Support of Motion For Summary Disposition ("Memorandum"), Exhibit B.) The Memorandum alleges that the OIP is invalid as a matter of law because

¹ The filing included proposed Orders.

the Commission's rules provide that only the Commission may authorize the institution of an administrative proceeding to impose remedial sanctions, and there is no statute or rule that authorizes a single Commissioner to act on behalf of "the Commission" to initiate this type of proceeding, citing certain informal and other Commission procedures and Rule 141 of the Commission's Rules of Practice. See 17 C.F.R. §§ 201.141; 202.5(b). (Memorandum at 2-3.) The Memorandum notes that the Commission modified its rules in 1995 to provide that:

A quorum of the Commission shall consist of three members; provided, however, that if the number of Commissioners in office is less than three, a quorum shall consist of the number of members in office; and provided further that on any matter of business as to which the number of members in office, minus the number of members who either have disqualified themselves from consideration of such matter pursuant to § 200.60 or are otherwise disqualified from such consideration, is two, two members shall constitute a quorum for purposes of such matter.

17 C.F.R. § 200.41. The Commission did not believe it necessary when it adopted the change in quorum requirements "to provide that one commissioner may constitute a quorum when disqualifications result in only one commissioner being available to deal with a particular matter." Establishment of Commission Quorum Requirement, 58 SEC Docket 3065, 3066 (Apr. 5, 1995).

Ernst & Young contends that the OIP was not validly issued because the governing rule requires that a minimum of two Commissioners participate in such a decision so that issuance of the OIP violated the Commission's regulations, citing IMS, P.C. v. Alvarez, 129 F.3d 618, 621 (D.C. Cir. 1997) ("[I]t is a 'well-settled rule that an agency's failure to follow its own regulations is fatal to the deviant action.'" (citations omitted)). It disagrees with the Division and Chief Accountant that the following provide a legal basis for the Commission's action: Section 4A of the Securities Exchange Act of 1934 ("Exchange Act"), 17 C.F.R. § 200.43, and the holding in SEC v. Feminella, 947 F. Supp. 722, 724-27 (S.D.N.Y. 1996). Finally, Ernst & Young maintains that the action by one Commissioner is inconsistent with the nature of the Commission as a multi-member, independent, deliberative body.

Division and Chief Accountant's Opposition to Motion For Summary Disposition

The Division and Chief Accountant state that the decision to issue the OIP was made by Commissioner Isaac C. Hunt, Jr., acting as duty officer pursuant to delegated authority. They argue that the Commission was able to act in this manner because Section 4A of the Exchange Act empowered the Commission to delegate to a single Commissioner the decision whether or not to commence an enforcement action.

The Securities and Exchange Commission shall have the authority to delegate, by published order or rule, any of its functions to . . . an

individual Commissioner, . . . including functions with respect to . . . ordering . . . or otherwise acting as to any work, business or matter.

The Commission implemented use of this Congressional grant of authority in its “duty officer rule,” 17 C.F.R. § 200.43.

- (a) *Delegation to duty officer.* . . . [T]he Commission hereby delegates to an individual Commissioner, to be designated as the Commission’s “duty officer” . . . all of the functions of the Commission; *Provided however,* That no such delegation shall authorize the duty officer (i) to exercise the function of rulemaking . . . ; (ii) to make any rule . . . ; or (iii) to preside at the taking of evidence

...

- (b) *Exercise of duty officer authority.* (1) The authority delegated by this rule shall be exercised when, in the opinion of the duty officer, action is required to be taken which, by reason of its urgency, cannot practicably be scheduled for consideration at a Commission meeting.

The Division and Chief Accountant maintain that if Congress intended to require that multiple Commissioners act to institute an enforcement action, it would have expressly forbade single Commissioner action in Section 4A as it did with respect to rulemaking. They disagree with Ernst & Young that the quorum rules prohibit action by one Commissioner, but view them as evidencing a preference for deliberative action where possible.

The Division and Chief Accountant insist that this duty officer action authorizing the OIP was a legitimate action by the Commission, and that the Commission is not limited to acting solely through Commission meetings governed by the quorum rules, citing R.R. Yardmasters of Am. v. Harris, 721 F.2d 1332, 1341 (D.C. Cir. 1983.) They maintain that Ernst & Young is wrong that the OIP was not issued “by the Commission” and cite Rule 200.43(c)(3) that states, “[a]ffirmed or unaffirmed action taken by the duty officer shall be deemed to be, for all purposes, the action of the Commission unless and until the Commission directs otherwise.” 17 C.F.R. § 200.43(c)(3).

The Division and Chief Accountant insist that the administrative law judge assigned to this proceeding has no authority to rule on the Motion For Summary Disposition because Rule 43 provides that only the Commission can review the action of a duty officer and judicial review violates the principles of separation of powers and administrative law, citing Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971); Morgan v. United States, 304 U.S. 1, 18, (1938); and Advanced Micro Devices v. CAB, 742 F.2d 1520, 1546 (D.C. Cir. 1984). In their opinion, action by the presiding administrative law judge would be ill suited judicial review of the Commission’s decision to initiate an enforcement proceeding, citing Wayte v. United States, 470 U.S. 598, 607-08 (1985).

The Division and Chief Accountant assert that there is no basis for halting the proceeding because, contrary to Ernst & Young's claims, there is no legal defect underlying the institution of the proceeding and no lack of "subject matter jurisdiction." Ernst & Young has not shown the irreparable injury necessary to grant the relief requested, which the Division and Chief Accountant view as something in the nature of a request for a stay pending an appeal to the Commission, citing FTC v. Standard Oil Co. of Cal., 449 U.S. 232, 244 (1980), and Renegotiation Bd. v. Bannercraft Clothing Co., 415 U.S. 1, 24 (1974).

Finally, the Division and Chief Accountant opine that a quorum of the Commission is likely to be available in the near future and will, in accordance with the duty officer rule, have an opportunity to review Commissioner Hunt's action instituting the OIP.

Ruling

I have considered all the arguments advanced by the parties.

Authority of Administrative Law Judge

Summary disposition or summary judgment is a judgment granted on a claim about which there is no genuine issue of material fact and upon which the movant is entitled to prevail as a matter of law. See Black's Law Dictionary 1449 (7th ed. 1999). There are no evidentiary issues presented here. The question is whether the proceeding was lawfully authorized "by the Commission." Questions of this character that challenge the legitimacy of a proceeding are addressed initially or else they can be waived. "Lack of capacity, authority, or legal existence are defenses that may be waived if not raised in a timely manner." James WM. Moore, 2 Moore's Federal Practice § 9.02[6] (3rd ed. 1997) (citations omitted).

I find that the administrative law judge assigned to handle this proceeding has authority to rule on the Motion For Summary Disposition presented here. The primary bases for my conclusion are the general nature of the presiding officer position and Rules 111 and 250 of the Commission's Rules of Practice.² See 17 C.F.R. §§ 201.111, .250.

The OIP ordered that:

a public hearing for the purpose of taking evidence on the issues set forth in Section III above shall be convened not earlier than 30 days and not later than 60 days from the service of this order at a place and time to be fixed and before an Administrative Law Judge to be designated by further

² "The procedure at the hearing is much the same as that in a non-jury trial in equity, with full cross-examination. The hearing officer regulates the course of the hearing and rules on offers of proof and the admissibility of evidence." Louis Loss, Securities Regulation 1130 (1951).

order, as provided by Rule 200 of the Commission's Rules of Practice, 17 C.F.R. § 201.200.

Rule 111 provides that “[t]he hearing officer shall have the authority to do all things necessary and appropriate to discharge his or her duties.” Rule 111 enumerates some, but not all, of the hearing officer's powers. That enumeration specifies that the powers of the hearing officer include “considering and ruling upon all procedural and other motions,” subject to any limitation set forth elsewhere in the rules. 17 C.F.R. § 201.111(h). There is no provision in the Rules that limits or prohibits determinations by a hearing officer on Motions for Summary Disposition. See Clarke T. Blizzard, 77 SEC Docket 1515, 1517 (April 24, 2002) (Rule 103 of the Rules of Practice provides that the Rules are to be construed “to secure the just . . . determination of every proceeding.”).

Case law recognizes both the strong similarities that exist between the role of a federal administrative law judge and that of a federal district court judge in a civil proceeding, as well as the common features shared by administrative proceedings and judicial proceedings.³ See Fed. Mar. Comm'n v. South Carolina State Ports Auth., 122 S. Ct. 1864, 1872-73 (May 28, 2002); Butz v. Economou, 438 U.S. 478, 513 (1978). Inasmuch as the jurisdictional question presented here is common in federal civil litigation, it is reasonable that, similar to a federal district court judge, a federal administrative law judge is empowered to decide the issue.

“Jurisdiction to determine jurisdiction” refers to the power of a court to determine whether it has jurisdiction over the parties to and the subject matter of a suit. If the jurisdiction of a federal court is questioned, the court has the power and the duty, subject to review, to determine the jurisdictional issue.

Charles Allen Wright, 13A Federal Practice and Procedure § 3536, at 535 (2d ed. 1984).

Rule 250 describes the subject of a motion for summary disposition as any or all allegations of the OIP. See 17 C.F.R. § 201.250. Here, Ernst & Young maintains that the Commission did not issue the OIP, a most basic representation or allegation.⁴ The Comment to Rule 250 notes that the motion is a procedure that can resolve issues prior to hearing, thereby reducing the costs of hearing and expedite resolution of the proceeding.

³ By noting these similarities, I am not inferring that a federal administrative law judge has all the authority of an Article III judge. However, at the trial stage of an administrative proceeding, the administrative law position at the Commission is sufficiently similar to the work of the United States district court judge that under the Commission's Rules of Practice, I am required by the nature of my position to rule on the Motion For Summary Disposition.

⁴ Ernst & Young has satisfied the requirement that leave to file the motion must be requested where a motion for summary disposition occurs following submission of an answer, but prior to submission of the Division's case in chief.

In the Revision Comment that appears in the Federal Register publication of Rule 250, the Commission stated that:

Rule 250 expressly permits a dispositive motion prior to hearing to be made and decided by the hearing officer, a reversal of practice under former Rule 11(e), which required such decisions to be made by the Commission.

60 Federal Register 32767 (June 23, 1995).

I find the arguments of the Division and Chief Accountant that the presiding administrative law judge has no power to rule on this Motion For Summary Disposition to be unpersuasive. They contend that if I decide the Motion, I will be substituting my judgment for that of Commissioner Hunt. I disagree. In this situation I do not substitute my judgment for that of the Commissioner because the issue here is not whether the Commission should have exercised its prosecutorial discretion. The issue is whether, given the particular circumstances of this case, the OIP is valid as a lawful exercise pursuant to the Commission's procedural rules. Another reason for rejecting the Division and Chief Accountant's arguments is that the reasoning that underlies their position would prevent a presiding officer from ever ruling on any dispositive motion, a result that contradicts the authority granted by Rule 250. Finally, the fact that Rule 43 provides for Commission review does not impede or prevent the ability of a presiding officer from reviewing an OIP pursuant to Rule 250. Rule 43 does not contain any such limitation.

Summary Disposition

Section 4A(a) of the Exchange Act provides the Commission with authority to delegate any of its functions to an individual Commissioner by published order or rule. See 15 U.S.C. § 78d-1(a); SEC v. Feminella, 947 F. Supp. 722, 726 (S.D.N.Y. 1996). Section 4A(b) provides that the Commission shall have the discretionary right to review the exercise of any action by an individual Commissioner. Also, in certain circumstances a person adversely affected by delegated action is entitled to review by the Commission.⁵ See 15 U.S.C. § 78d-1(b).

The Commission has implemented this broad grant of authority with four rules that provide a coherent structure of delegation. See 17 C.F.R. §§ 200.40-.43. The second rule establishes what shall constitute a quorum for the conduct of Commission business.⁶ A quorum of the Commission shall consist of three members, but where the number of Commissioners in office minus the number of Commissioners who have disqualified

⁵ Where, as here, it is not obvious from the OIP that this action occurred pursuant to delegated authority, I do not know how someone in one of the categories specified in Section 4A(b) would know he or she could seek Commission review.

⁶ A quorum is "[t]he minimum number of members who must be present at the meetings of a deliberative assembly for business to be legally transacted." H. Robert, Robert's Rules of Order 16 (rev. ed. 1981).

themselves is two, then two members shall constitute a quorum. See 17 C.F.R. §200.41. The Division and Chief Accountant do not challenge Ernst & Young's claim that a quorum was not available on May 15, 2002, when Commission Hunt decide to institute this proceeding. (Memorandum, Exhibit B.)

The Commission's rules for disposition of business by exercise of authority delegated to an individual Commissioner are in Rule 43.⁷ See 17 C.F.R. § 200.43. The Commission's Secretary, Jonathan G. Katz, represents that Commissioner Hunt made the Commission decision to institute the proceeding on May 15, 2002, acting as Duty Officer Commissioner pursuant to Rule 43. (Opposition to Respondent's Motion For Summary Disposition, Exhibit 1.) The OIP is dated May 20, 2002.

I find that in these circumstances the use of Rule 43 as authority was plainly erroneous and inconsistent with the plain language of the Rule, despite the deference due to the representation by the Division and Chief Accountant that the OIP was issued "by the Commission." See Federal Procedure, Lawyers Edition § 2.323, at 307-08 (1994) (An agency's construction of its own regulations is entitled to substantial deference, and its interpretation is controlling unless plainly erroneous or inconsistent with the regulation.) It is worth noting that the arguments advance by the Division and Chief Accountant in support of the OIP are their litigation position, and not a definitive interpretation of the Commission. The Commission has not yet taken a position on the issue.

On its face, Rule 43, which authorizes delegation to the Duty Officer of all the Commission's functions, is inapplicable in this situation. Rule 43(b)(1) states that the authority delegated shall be exercised "when, in the opinion of the duty officer, action is required to be taken which, by reason of its urgency, cannot practicably be scheduled for consideration at a Commission meeting." The Division and Chief Accountant did not respond to Ernst & Young's assertion that use of the Rule was improper with any plausible explanation as to why initiating this proceeding on May 15, 2002, was such an urgent action that it could not be scheduled for Commission consideration. Having failed to make any kind of plausible showing, the Division and Chief Accountant's argument that judicial review should not attempt to determine the mental state of Commissioner Hunt is irrelevant.

The holding in R.R. Yardmasters of Am. v. Harris, 721 F.2d 1332, 1341 (D.C. Cir. 1983), which upheld a delegation by two members of the National Mediation Board ("Board"), a three-person panel, to one member who exercised the authority when he was

⁷ Congress authorized the Commission to delegate authority in 1962. See Pub. L. No. 87-592, 76 Stat. 39 (Aug. 20, 1962) (repealed by Pub. L. No. 100-181). The Commission promulgated the first delegation rules in 1977 in response to the "Sunshine Act." See Public Observation of Commission Meetings, Information and Requests, and Related Matters, 11 SEC Docket 1611 (Feb. 2, 1977) (notice of proposed rulemaking), and 11 SEC Docket 1922 (Mar. 10, 1977) (final rulemaking action). The Commission amended Rule 43 in 1994 and redesignated and amended the rule again in 1995.

the only Board member is not relevant here. The delegation at issue there authorized and empowered an individual member “to exercise without further authorization all official actions whatsoever on behalf of the” Board. See id. at 1335. The statutory authority that allowed the delegation order in Yardmasters was broader than that of this Commission in Section 4A of the Exchange Act. See id. at 1339-40. There is no question that this Commission can transact business either at a meeting attended by a quorum or by an individual Commissioner acting for the Commission pursuant to a lawful delegation order. The issue here is whether the OIP was a valid exercise of the Commission’s procedural rules that allow a single commissioner to act for the Commission in urgent circumstances.

Several pieces of circumstantial evidence further support my conclusion that the issuance of the OIP was not “by the Commission” because it was not a legitimate exercise of Rule 43. The Rule provides that the Commission shall affirm the duty officer’s action at the earliest practicable date. See 17 C.F.R. § 201.43(c). Commissioner Hunt decided to issue the OIP more than six weeks ago, and the Commission has not affirmed his action because, as was the situation on May 15, 2002, he is the only Commissioner available for consideration of this issue. There does not seem to be any precedent for this type of action “by the Commission.” (Prehearing Conference June 6, 2002, at 4.)

Rule 43’s explicit authority to “order a nonpublic formal investigation proceeding” negates the view of the Division and Chief Accountant that an expansive reading of the Rule allows the action. The fact that the Commission determined it necessary to include this language in the Rule indicates that it believed that Rule 43 did not already include such authority. In 1995, when it modified its quorum rules, the Commission made comments that suggest that one Commissioner has no authority to act in non-urgent situations. In adopting a rule that allowed a three-person quorum with exceptions it noted that, “[a]lthough this rule may create difficulties when only three Commissioners are in office, these difficulties are outweighed by the benefits of having all three commissioners deliberate and vote on matters.” Quorum Requirement, 58 SEC Docket at 3065. It noted further that in the past it had resorted to the duty officer procedure to deal with urgent matters as to which only two commissioners were available, and it determined that it did “not believe it [was] necessary, at this time, to provide that one commissioner may constitute a quorum when disqualifications result in only one commissioner being available to deal with a particular matter.” Id. at 3066. The Division and Chief Accountant have not cited any public interest considerations that suggest it was urgent to initiate the proceeding on May 15, 2002. The activities that are the subject of the proceeding occurred from 1994 through 2000, and there does not appear to be any statute of limitations concerns. (OIP at 1.) Ernst & Young filed a “Wells Submission” on June 11, 2001, which indicates that the Commission had the allegations in the OIP under consideration for eleven months. (Reply at 2.)

The legislative history to the amendments to the Exchange Act, Section 4A, that allow the Commission to delegate authority includes the Securities and Exchange Commission Comments on S. 2135, to the Committee on Banking and Currency, United

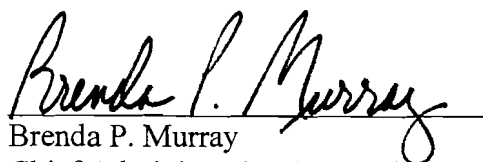
States Senate, accompanying S. Rep. No. 87-776 (1961) (“Comments”). Bill S. 2135, enacted as Pub. L. No. 87-592 (repealed), gave the Commission broad power to delegate its functions to personnel below the level of the full Commission. In discussing the means available to persons who believed that they were aggrieved by a Commission delegation, the Commission stated that:

a person who believes that an injunction action was improperly commenced can present his objections to the court; and a person similarly objecting to the institution of an administrative proceeding can promptly raise his objections in the proceeding.

Comments at 5. The legislative history also contains the statement of William L. Cary. See Reorganization Plans Nos. 1, 2, 3, and 4 of 1961: Hearings Before a Subcommittee of the Committee on Government Operations, House of Representatives, 87th Cong. (1st Sess. May 18, 1961) (statement of William L. Cary, Chairman, Securities and Exchange Commission) (“Statement”). Commission Chairman Cary’s comments are relevant since the OIP at issue seeks to discipline Ernst & Young. Chairman Cary listed “disciplinary proceedings” where the “Commission seeks to bar attorneys or accountants from professional practice before it,” as a subject that the Commission would not delegate to less than the full Commission. “The consequences of disbarment are so far reaching with respect to the person involved that I feel we should authorize such proceedings only upon the basis of the judgment of the entire Commission.” Statement at 13.

Finally, the interpretation advanced by the Division and Chief Accountant that “urgency” is not a part of the duty officer rule, or that urgency can reside only in the mind of the beholder, would render the quorum rules meaningless as all “regular” Commission actions could be performed by a single commissioner. Nothing in the Congressional delegation of authority or a reasonable reading of the Commission’s promulgations envisioned such a result.

For all the reasons stated, I GRANT Ernst & Young’s request to file the Motion For Summary Disposition. I GRANT the Motion For Summary Disposition, and DISMISS the proceeding without prejudice.⁸


Brenda P. Murray
Chief Administrative Law Judge

⁸ This determination eliminates the need for a ruling on Ernst & Young’s Motion For More Definite Statement.