UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 724 / September 14, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14856

In the Matter of	:	
	:	ORDER ON RENEWED MOTION OF
EGAN-JONES RATINGS COMPANY and	:	THE DIVISION OF ENFORCEMENT
SEAN EGAN	:	TO STRIKE AFFIRMATIVE DEFENSES
	:	9-11, 13-18, AND 24-25

The Securities and Exchange Commission (Commission) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on April 24, 2012, pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934 (Exchange Act). Respondents filed their Answer on June 1, 2012, which contains numerous affirmative defenses. Some of these affirmative defenses were stricken by Order issued July 13, 2012 (Strike Order). I thereafter issued an Order on August 8, 2012 (Administrative Proceedings Ruling Release No. 716 (AP Ruling 716)), directing Respondents to file a More Definite Statement. Respondents filed the MDS on August 20, 2012.

Pending before me is the Renewed Motion of the Division of Enforcement (Division) to Strike Affirmative Defenses 9-11, 13-18, and 24-25 (Renewed Motion). Respondents filed an Opposition (Opposition) thereto, and the Renewed Motion is now ripe for decision.[1]

I. Legal Standard

The "accepted practice in Commission proceedings is to strike affirmative defenses which would not constitute a valid defense." Piper Capital Mgmt., Inc., Administrative Proceedings Release No. 577 (Jan. 15, 1999), 68 SEC Docket 3361, 3364 (citing Gregory L. Amico, Administrative Proceedings Ruling Release No. 460 (Dec. 15, 1994), 58 SEC Docket 850, 851). A defense may be stricken if it is not a valid defense under any set of facts, so that

[1] The Division filed a Reply, Respondents thereafter submitted a letter requesting permission to file a sur-reply, and the Division submitted a letter in opposition. Although I have reviewed all of the parties' filings, I have ruled on the Renewed Motion without relying on the Reply. According, Respondents' request to file a sur-reply is denied as moot.

evidence in support of it would be irrelevant. See Jeffrey Feldman, Release No. APR-403 (Jan. 14, 1994), 55 SEC Docket 2960, 2962 (citation omitted).[2]

II. Specific Defenses

A. Selective prosecution (defenses 14-18)

Selective prosecution "relates not to the guilt or innocence of [Respondents], but rather addresses itself to a constitutional defect in the institution of the prosecution." U.S. v. Berrigan, 482 F.2d 171, 175 (3rd Cir. 1973). Prosecutions are presumed to be "undertaken in good faith and in nondiscriminatory fashion for the purpose of fulfilling a duty to bring violators to justice." U.S. v. Torquato, 602 F.2d 564, 569 (3rd Cir. 1979) (quotation omitted). The Third Circuit, which I assume is the Circuit whose law applies, recognizes selective civil enforcement claims (as well as selective criminal prosecution claims). Dique v. N.J. State Police, 603 F.3d 181, 188 n.10 (3rd Cir. 2010); see also Davis v. Malitzki, 451 F.App'x 228, 234 n.11 (3rd Cir. 2011) (noting that the two different claims employ "virtually identical" legal standards). To establish selective civil enforcement in the Third Circuit, a respondent must provide evidence that (1) persons similarly situated (2) were not the subject of enforcement actions despite their non-compliance with the law, and (3) this selective treatment was based on an unjustifiable standard, such as race, religion, or some other arbitrary factor, or to prevent the exercise of a fundamental right. See Hill v. City of Scranton, 411 F.3d 118, 125 (3rd Cir. 2005) (quotation omitted). The defendant bears the burden of proving the defense with "'clear evidence' sufficient to overcome the presumption of regularity that attaches to decisions to prosecute." U.S. v. Taylor, 686 F.3d 182, 197 (3rd Cir. 2012) (quoting U.S. v. Armstrong, 517 U.S. 456, 464 (1996)).

I previously ordered Respondents to state whether any of their defenses 14-18 were selective prosecution defenses, and if so, to identify the "others similarly situated." AP Ruling 716, p. 4. Respondents did not explicitly state that defenses 14-18 were selective prosecution defenses, but they do not dispute the Division's characterization of them as such. Compare MDS, pp. 7, 10-18 with Renewed Motion, p. 6 and Opposition, p. 6.

The MDS is very clear regarding Respondents' membership in a class: "First, Respondents are members of a subscriber-paid [nationally recognized statistical rating organization (NRSRO)] class of which Egan-Jones is the last." MDS, p. 10. The Opposition is similarly clear regarding membership in a class: "Respondents are part of the class of independent subscriber-paid NRSROs which the SEC clearly and obviously has singled out for enforcement different than the other conflicted, issuer-paid NRSROs." Opposition, p. 15. I conclude that defenses 14-18 assert claims for selective prosecution based on membership in the class of subscriber-paid NRSROs, where the others similarly situated but not prosecuted are non-subscriber-paid (i.e., issuer-paid) NRSROs.

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. U.S. v. Am. Elec. Power Serv. Corp., 258 F.Supp.2d 804, 807-08

[2] During the prehearing conference held on August 1, 2012, I clarified that the Division was granted permission to file the instant Renewed Motion. The Division has now done so, making generally new arguments. The law of the case doctrine is inapplicable. Opposition, p. 21.

(S.D. Ohio 2003); see generally Renewed Motion, pp. 12-14. 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.

B. First Amendment (defenses 10 and 11)

To establish a First Amendment retaliation claim in an affirmative civil case under federal civil rights laws, a plaintiff must prove the following elements: (1) constitutionally protected conduct; (2) that the prosecutor/enforcer took adverse action sufficient to deter a person of ordinary firmness from exercising his rights; (3) a causal connection between the two; and (4) the absence of probable cause for the enforcement action. Walker v. Clearfield Cnty. Dist. Attorney, 413 F.App'x 481, 483 (3rd Cir. 2011) (citing Hartman v. Moore, 547 U.S. 250, 265-66 (2006); Miller v. Mitchell, 598 F.3d 139, 154 (3rd Cir. 2010)).

I previously ordered Respondents to clarify defenses 10 and 11, and suggested that defense 11 might state a selective prosecution claim. AP Ruling 716, p. 3. The MDS clarified that defense 10 asserts that Respondents "are being retaliated against," with no mention of selectivity, protected classes, or others similarly situated. MDS, pp. 18-19. The MDS clarified that defense 11 asserts "retaliation for the past exercise of protected First Amendment activity . . . [and] is an attempt to frustrate future protected First Amendment exercise." MDS, p. 20. As with defense 10, there is no mention of selectivity, protected classes, or others similarly situated. MDS, pp. 20-21.

The Division nonetheless characterizes defenses 10 and 11 as selective prosecution claims. Renewed Motion, pp. 14-16. Respondents concur with this characterization, even though it is not supported by either the Answer or the MDS. Opposition, p. 19. Specifically, they contend that "Egan-Jones is now the last remaining subscriber-paid NRSRO and therefore now is a class of one . . . [and] has pleaded clearly and with particularity the improper motives in its selective prosecution affirmative defenses." Id.

For the reasons stated in analyzing defenses 14-18, to the extent defenses 10 and 11 are construed as selective prosecution claims based on membership in the class of subscriber-based NRSROs, they are appropriately stricken. It is possible that Respondents meant to assert First Amendment-based selective prosecution defenses similar to the one Gupta asserted: "the SEC intentionally, irrationally, and illegally singled Gupta out for unequal treatment in a bad faith attempt to deprive him of constitutional and other rights, in retaliation for his strenuous assertion of his innocence." Gupta v. SEC, 796 F.Supp.2d 503, 513 (S.D.N.Y. 2011). But while they contain voluminous references to bad faith and improper motives, neither defense 10 nor 11, nor their clarification in the MDS, contain Gupta's "selective prosecution" language – no "singled out," no identification of others similarly situated, and no allegation of disparate treatment. See Renewed Motion, p. 15 (arguing that defenses 10 and 11 do not plead disparate treatment). Notwithstanding Respondents' apparent agreement that defenses 10 and 11 are selective prosecution claims – which warrants striking them – they cannot be fairly construed as such.

Nor are defenses 10 and 11 properly construed as "class of one" claims, as Respondents now appear to contend. See Opposition, pp. 18-19 (citing Village of Willowbrook v. Olech, 528 U.S. 562 (2000); Esmail v. MacRane, 53 F.3d 176, 180 (7th Cir. 1995)); but see Am. Elec. Power, 258 F.Supp.2d at 808 ("class of one" defenses may not be raised in statutorily-authorized federal civil enforcement cases). Respondents assert, for example, that "arbitrary actions against individuals in creating and enforcing legislation not rationally related to any legitimate state interest is improper and proscribed." Opposition, p. 18. But defenses 10 and 11 cite only to the First Amendment, not to equal protection principles or to the Due Process clause's "rational basis" test. Answer, p. 16. The MDS, similarly, is silent on equal protection and due process but repeatedly references the First Amendment and repeatedly asserts "retaliation." MDS, pp. 18-21. Respondents' interpretation of these defenses as based on Olech is erroneous.

Instead, they are best read as First Amendment retaliation claims. One element of a retaliation claim that is not required in a selective prosecution claim is proof of an absence of probable cause for the enforcement action. Walker, 413 F.App'x at 483. Such an element is needed for two reasons. First, it aids in establishing causation: "It may be dishonorable to act with an unconstitutional motive . . . but action colored by some degree of bad motive does not amount to a constitutional tort if that action would have been taken anyway." Hartman, 547 U.S. at 261. Second, there exists a "longstanding presumption of regularity accorded to prosecutorial decisionmaking," which entitles the prosecutor's decisions a degree of deference. Id. at 263.

Hartman holds that "an absence of probable cause . . . must be pleaded and proven" for claims of retaliatory prosecution. 547 U.S. at 265-66; see also Miller, 598 F.3d at 154. I see no principled distinction between this case and Hartman for purposes of determining the elements of a retaliation claim; that this is a case where retaliation is a defense rather than one where retaliation is the cause of action makes no difference. Respondents, citing Pavone v. Puglisi, 353 F.App'x 622, 625 (2d Cir. 2009), argue that only the first three elements recited in Walker need to be pleaded. Opposition, p. 18. But Pavone apparently does not deal with retaliatory prosecution and is therefore inapposite. As the Division correctly argues, engaging in protected speech does not by itself immunize unlawful conduct. Renewed Motion, p. 16 (citing Wayte v. U.S., 470 U.S. 598, 613-14 (1985)). I therefore disagree with Respondents regarding the elements of a retaliation claim, and conclude that Respondents must plead and prove that the alleged retaliatory OIP lacked probable cause for its issuance.[3]

It is conceivable that there was no probable cause to issue the OIP. If there was probable cause, defenses 10 and 11 must be stricken; if not, Respondents will have to show that they have sufficiently pleaded the remaining elements of a retaliation claim. I believe the most judicially efficient way of resolving this issue is to first determine whether there was probable cause. I suspect that this can be determined fairly easily with an in camera review of certain documents. To this end, I order a prehearing conference to discuss the mechanics of such a review. I also

[3] Respondents have not pled lack of probable cause, and I could strike these two defenses on that basis alone. However, I have determined that review of certain documents in camera will be useful in resolving multiple issues presented by the Renewed Motion, as explained further below. I therefore defer ruling on this issue until after completion of the in camera review.

defer ruling on this portion of the Renewed Motion, in view of the potentially dispositive nature of an in camera review.

C. Credit Reform Act (defense 13)

Defense 13 asserts that the Commission issued the OIP "in direct contravention of two acts of the United States Congress." Answer, p. 16. I ordered Respondents to identify the alleged acts and the specific sections of those acts allegedly contravened. AP Ruling 716, p. 3. Respondents identified 15 U.S.C. § 78o-7 (MDS, p. 2), as well as several sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) (MDS, pp. 4-5), which have allegedly been violated. But as the Division correctly notes, whether 15 U.S.C. § 78o-7 has been violated is the precise issue presented by this proceeding, and this proceeding is not precluded by any cited section of Dodd-Frank. Indeed, the cited sections of Dodd-Frank contain absolutely no language establishing an adjudicable cause of action or affirmative defense. In response, Respondents say essentially nothing of substance. Opposition, p. 21. Defense 13 cannot provide a valid defense under any set of facts, and will be stricken.

D. Prejudgment (defense 9)

Defense 9 asserts that the Commission "appears to have prejudged the merits of this case." Answer, p. 16. I previously ruled, based on the Division's argument that defense 9 amounted to an equitable estoppel claim, that defense 9 would not be stricken. Strike Order, p. 4. I also previously ruled, in resolving the Division's Motion for More Definite Statement, that the "Commission has stated that it authorizes administrative proceedings based on its own consultations, deliberations, and conclusions with respect to the Division's recommendations [and that] the Division could respond to [defense 9] with evidence pertaining to the Commission's vote to issue the OIP." AP Ruling 716, p. 3 (citation omitted). Although the Division argues that this is not a valid defense, because of the "presumption of regularity" of Commission proceedings, it concedes that this presumption can be rebutted by evidence of "a colorable showing [of] impropriety by the Commission." Renewed Motion, p. 23 (citing Attorney General of the U.S. v. Irish People, Inc., 684 F.2d 928, 947-48 (D.C. Cir. 1982)). As with defense 13, Respondents say essentially nothing of substance in response, and in particular make no such "colorable showing." Opposition, p. 21.

In view of the almost complete lack of support for this defense, I am inclined to agree with the Division and strike it without further proceedings. However, it would be prudent to examine in camera the documents referenced above, which are likely to also constitute "evidence pertaining to the Commission's vote to issue the OIP," and which may be dispositive of defense 9. AP Ruling 716, p. 3. Out of an abundance of caution, I will defer ruling on this defense, as well, until after reviewing such evidence in camera. If I find no evidence of irregularity or impropriety, defense 9 will be stricken.

E. Improper procedures (defenses 24 and 25)

Defense 24 asserts that a leak to the press by "an SEC official" disclosing the fact that the Commission was going to vote to issue the instant OIP "influence[d] corruptly the Commission's otherwise confidential deliberative process." Answer, p. 19. The MDS provides factual details and further alleges, in sum and substance, that the Commission's deliberations were supposed to

be closed pursuant to 5 U.S.C. § 552b, but in effect were not, were not impartial, were the subject of outside influence, and resulted in insufficient consideration of Respondents' Wells submissions. MDS, pp. 21-22. Defense 25 asserts, in sum and substance, that certain Commission staff members were improperly designated and employed during the Division's investigation of Respondents. Answer, p. 19. Respondents had previously listed the precise statutory and regulatory provisions allegedly violated in defense 25, namely, 17 C.F.R. §§ 200.19b and 200.19c and 15 U.S.C. § 78p(b). MDS, p. 22; AP Ruling 716, p. 5. Respondents now additionally cite the Administrative Procedures Act, 5 U.S.C. § 302(b) and §§ 551 et seq. Opposition, p. 22. Although I ordered a more definite statement as to this defense, the MDS adds nothing except disclosure of the identities of the implicated employees.[4] MDS, p. 22.

The Division argues persuasively that none of the statutory or regulatory provisions cited by Respondents as to these defenses provides a cause of action or affirmative defense. Renewed Motion, pp. 17-19; see, e.g., Buntrock v. SEC, 347 F.3d 995, 998-99 (7th Cir. 2003) ("the exclusionary rule is not a proper remedy for a violation of agency regulations"). In response, Respondents argue, citing Barry v. U.S., 865 F.2d 1317 (D.C. Cir. 1989), and U.S. v. Meyer, 810 F.2d 1242 (D.C. Cir. 1987), that the allegations of defense 24, if proven, may constitute prosecutorial misconduct warranting dismissal. Opposition, p. 22.

Although I have in some instances applied principles of criminal law and procedure to this case, as with my ruling on the selective prosecution defenses, I find that the criminal law is not as analogous to defense 24 as Respondents contend. Barry deals with a violation of grand jury secrecy, and notes that Federal Rule of Criminal Procedure 6(e)(2) explicitly provides that its violation "may be punished as a contempt of court." 865 F.2d at 1321 (emphasis and internal quotation omitted). Meyer addresses prosecutorial vindictiveness (as opposed to selection), where prosecutors increased the number of charges against certain defendants in response to the defendants' election of a jury trial in lieu of a guilty plea, and notes that a trial court has "broad authority to remedy prosecutorial vindictiveness." 810 F.2d at 1249. I find no explicit cause of action in 5 U.S.C. § 552b, in contrast to Federal Rule of Criminal Procedure 6(e)(2), and there is no allegation here of prosecutorial vindictiveness.

Assuming the alleged improper influence and corruption to be true, I see no principled distinction between this case and Buntrock, in which the Seventh Circuit held that "a civil defendant . . . does not have a constitutional right to a conflict-free agency determination of whether to sue him civilly unless the conflict laps over into the trial." 347 F.3d at 999. To be sure, "the trial" in this case may be subject to review by the Commission on appeal, but this does not mean that the facts alleged in defense 24 necessarily imply a fatal defect in a review process that may never take place. There is no set of facts that could be proven, consistent with defense 24's allegations, that would entitle Respondents to relief, and defense 24 will be stricken.

As to defense 25, Respondents cite to no case law, and indeed, make essentially no effort to rebut the Division's aruguments beyond their points pertaining to defense 24. I conclude that defense 25, too, does not state an affirmative defense, and it will be stricken.

[4] This failure alone is likely sufficient to strike defense 25.

Order

The Renewed Motion of the Division of Enforcement to Strike Affirmative Defenses 9-11, 13-18, and 24-25 is GRANTED IN PART and DEFERRED IN PART, as outlined above.

I ORDER a prehearing conference to be held on September 19, 2012 at 11:30 EDT to discuss in camera review of documents. The parties should contact this Office if they desire a different date or time for the conference.

Cameron Elliot
Administrative Law Judge