

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDINGS RULINGS

Release No. 716 / August 8, 2012

ADMINISTRATIVE PROCEEDING

File No. 3-14856

In the Matter of	:	
	:	ORDER ON MOTION FOR A MORE
EGAN-JONES RATINGS COMPANY and	:	DEFINITE STATEMENT REGARDING
SEAN EGAN	:	AFFIRMATIVE DEFENSES
	:	

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).

Pending before me is the July 23, 2012 Motion of the Division of Enforcement (Division) for a More Definite Statement Regarding Affirmative Defenses and to Postpone Further Briefing on Striking Affirmative Defenses; Suggestion That a Scheduling Conference be Held on or Before August 1 (Motion), which included an associated Memorandum of Law (Memo). Respondents filed an Opposition (Opposition) thereto on July 30, 2012, which included Exhibits A, B, and C, and the Division filed a Reply (Reply) on August 2, 2012. I held a Scheduling Conference on August 1, 2012, at the Division's suggestion, at which time I orally held that the Division may file another motion to strike after the present Motion is fully resolved.

I now rule on the remainder of the present Motion, which is granted except as to Defense No. 9.

A. Legal Standard

In determining the legal standard to apply in resolving the Motion, I am guided by two considerations: each affirmative defense must at least be clear enough to determine whether it is valid, and each must be pled only with such particularity that the Division may adequately respond to it.

The "accepted practice in Commission proceedings is to strike affirmative defenses which would not constitute a valid defense." Piper Capital Mgmt., Inc., Admin. Proceedings Ruling Release No. APR-577 (Jan. 15, 1999), 68 SEC Docket 3361, 3364 (citing Gregory L. Amico, Admin. 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 evidence in support of it would be irrelevant. See Jeffrey Feldman, Admin. Proceedings Ruling Release No.

403 (Jan. 14, 1994), 55 SEC Docket 2960, 2962 (citation omitted). As noted in the Strike Order, some of Respondents' affirmative defenses are not clearly pled. In fact, some are so unclear that it cannot be determined whether they are even valid defenses. Therefore, at minimum, Respondents must assert their affirmative defenses clearly enough that their validity can be ascertained.

As to the precise degree of particularity required, I am not persuaded by the Division's argument that each defense must plead "supporting facts or elements" beyond that required for fair notice. E.g., Memo, p. 5 (regarding Defense No. 9). It would be incongruous to require more specificity of an affirmative defense than that required of an OIP. As the parties both concede, there is a split among courts over whether Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007), requires "heightened" pleading of affirmative defenses or simply traditional "notice" pleading. Moreover, the Division has pointed to no persuasive authority for the proposition that every affirmative defense must be pled with a particularity greater than that demanded by Twombly.

In any event, whether or not Twombly applies to affirmative defenses in civil cases, it has little bearing on the present Motion. This is because the most natural and balanced approach to resolving the Motion is to demand the same degree of particularity that would be required of an OIP that is the subject of a motion for more definite statement. Rule 200(b) of the Commission's Rules of Practice states that the OIP "shall set forth the factual and legal basis alleged therefor in such detail as will permit a specific response thereto." 17 C.F.R. § 201.200(b). It is well established that respondents in administrative proceedings are entitled to be sufficiently informed of the charges against them such that they may adequately prepare their defense; however, respondents are not entitled to a disclosure of evidence in advance of the hearing. See Charles M. Weber, 35 S.E.C. 79 (1953); see also M.J. Reiter Co., 39 S.E.C. 484 (1959). I have previously characterized this as the "distinction between allegations and evidence." Western Pacific Capital Mgmt., LLC, Admin. Proceedings Ruling Release No. 691 (Feb. 7, 2012), 102 SEC Docket 51083, 51085.

Applying this distinction here, I hold that, in general, each affirmative defense must be alleged with sufficient particularity that the Division may adequately prepare its response thereto, but need not recite or disclose the evidence that will be used to prove it. Additionally, as noted above, each affirmative defense must be pled clearly enough to ascertain its validity. Failure to assert a valid defense with the required degree of clarity and particularity may result in its being stricken without further briefing. Strike Order (deferring ruling on Defenses No. 10, 11, 13-18, 24, and 25). As to those defenses apparently alleging selective prosecution, in view of their notable lack of clarity, I will order that specific facts be pled, as explained below.¹ I therefore need not address the Division's argument that selective prosecution defenses always require a heightened pleading standard. Memo, p. 3.

Lastly, I agree with the Division's argument at the Scheduling Conference that clarity in pleading is best achieved by looking only at a limited universe of documents. Ideally, this

¹ Technically, as an administrative proceeding, there is no "prosecution" here, and such a defense is more properly called "selective civil enforcement." See U.S. v. American Electric Power Service Corp., 258 F.Supp.2d 804, 807 (S.D.Ohio 2003). Because the vast bulk of the case law on the subject calls it "selective prosecution," though, I do as well.

universe would consist only of the Answer, but I am willing to stretch the point to consider the Opposition, as well. Although I have reviewed all of Respondents' Exhibits, I conclude that a mere page citation to an Exhibit, which might be interpreted as an incorporation by reference, is inadequate to render an affirmative defense sufficiently clear and particular. Accordingly, I hold that if any facts and allegations necessary to meet the standard of "clearly pled and sufficiently particular" are not found in the Answer and Opposition, viewed together, then a more definite statement is in order.

B. Specific Defenses

Defense No. 9: More Definite Statement (MDS) not required.

This defense alleges that the "Commission appears to have prejudged the merits of this case." The Commission has stated that it authorizes administrative proceedings based on its own consultations, deliberations, and conclusions with respect to the Division's recommendations. Kevin Hall, CPA, Exchange Act Release No. 34-61162 (Dec. 14, 2009), 97 SEC Docket 23679, 23713 (quotation omitted). It would seem the Division could respond to this allegation with evidence pertaining to the Commission's vote to issue the OIP.² This defense is both clear and sufficiently particular.

Defense No. 10: MDS required.

This defense alleges that the OIP was issued "in retaliation for Egan-Jones and Mr. Egan exercising their rights under the First Amendment." It would seem the Division could rebut this allegation only if it was apprised of which credit ratings were at issue. Respondents clarified during the Scheduling Conference that the alleged retaliation was for issuing certain specific credit ratings, but the Answer and Opposition do not specify which. Accordingly, Respondents shall more definitely state which credit ratings led to the alleged retaliation, and when they were issued.

Defense No. 11: MDS required.

This defense alleges that "filing this OIP" constitutes a First Amendment violation "out of a motivation to diminish and reduce the effectiveness and visibility" of Respondents. This defense contains no clear legal theory. Respondents do not allege how the filing of the OIP has chilled their protected First Amendment activities or otherwise infringed their free speech rights. The use of the term "motivation" suggests a possible selective prosecution theory, but nothing else about the defense does. So stated, it does not seem possible for the Division to rebut this defense, nor can it be determined whether the defense is even valid. Accordingly, Respondents shall clarify and more definitely state this defense.

Defense No. 13: MDS required.

This defense alleges that the OIP was filed "in direct contravention of two acts" of Congress. Although Respondents helpfully identified the specific statutes in their Opposition, the mere citation to an act is insufficient to place the Division on notice of which provision has

² I express no opinion on whether such evidence would be discoverable.

allegedly been violated, or how. Accordingly, Respondents shall identify the specific language in each act allegedly violated, and briefly describe how the Commission allegedly committed each violation.

Defenses No. 14-18. MDS required.

These defenses allege that “filing this OIP” constituted a Due Process, Equal Protection, and First Amendment violation, but do not specify which specific constitutional provisions were allegedly violated. Defense No. 14 appears to allege that the filing of the OIP was a “demonstration of [the Commission’s] bias against” Respondents, that is, the filing was not itself a violation but is instead evidence of a violation. Defenses No. 15-18, by all referencing “bias” and a failure to bring charges against issuer-paid NRSROs, suggest a selective prosecution theory. However, Defense No. 15, like Defense No. 14, appears to allege that the filing of the OIP was a demonstration of the Commission’s alleged “favor for the issuer-paid model NRSROs,” that is, the filing is merely evidence of bias. Defenses No. 16 adds nothing except a recitation of the source of the alleged bias, namely, that issuer-paid NRSROs allegedly “provide significant potential sources of private sector employment” to Commission employees. Defense No. 17 alleges disparate treatment relative to issuer-paid NRSROs, but otherwise adds nothing. Defense No. 18 alleges that Respondents’ alleged violations are “dwarfed” by the harm allegedly caused by issuer-paid NRSROs, but otherwise adds nothing.

The Opposition attempts to clarify Defenses No. 15-18 by citing to certain pages in Respondents’ Wells Submission and Civil Complaint, and by suggesting that they are modeled after the defenses in Gupta v. SEC, 796 F. Supp. 2d 503 (2011). Opposition, pp. 20-21. But in Gupta, the plaintiff prevailed at the motion to dismiss stage only on an equal protection theory, specifically, a selective prosecution theory, albeit with a free speech element. Except for the bare reference to the First Amendment, nothing alleged in Defense Nos. 14-18 implicates free speech. Considering only the Answer and Opposition, it is entirely unclear which constitutional provision applies to each Defense or how it so applies. Respondents’ citation to their Wells Submission and Civil Complaint are enlightening but, as noted above, inadequate to avoid a more definite statement.

A successful selective prosecution defense requires proof that the respondent was singled out for enforcement action while others similarly situated were not, and that the prosecution was motivated by arbitrary or unjust considerations, such as race, religion, or the desire to prevent the exercise of a constitutionally-protected right. The Barr Financial Group, Inc., Investment Advisers Act Release No. 2179 (Oct. 2, 2003), 81 SEC Docket 828, 833 n. 15 (quotations omitted); Barry C. Wilson, 52 S.E.C. 1070, 1074 (1996); Donald T. Sheldon, Exchange Act Release No. 31475 (Nov. 18, 1992), 52 SEC Docket 3826, 3866 (citing U.S. v. Huff, 959 F.2d 731 (8th Cir. 1992)). Another entity is “similarly situated” if it “could have been prosecuted for the offenses for which respondents were charged.” U.S. v. Armstrong, 517 U.S. 456, 470 (1996). Liberally construed, it would seem that Defenses No. 14-18, if indeed they assert selective prosecution, assert it based on either membership in a protected class, namely, the class of subscriber-based NRSROs, or on exercise of First Amendment rights, namely, publication of credit ratings. It would also seem that the similarly situated others are issuer-paid NRSROs who could have been charged with violations of those sections of the Exchange Act and Exchange Act Rule 17g recited in the OIP. However, it is not clear that this is so.

Accordingly, Respondents shall state whether each of Defenses No. 14-18 are selective prosecution defenses. If not, any non-selective prosecution defense must be clarified to adequately state a valid defense. As to each of Defenses No. 14-18 which do assert selective prosecution, Respondents shall identify with particularity: (1) the others similarly situated, (2) the violations for which the similarly situated others could have been charged, and (3) the arbitrary or unjust motivation involved.

Defense No. 24: MDS required.

This defense alleges that “an SEC official . . . corruptly [influenced] the Commission’s otherwise confidential deliberative process regarding whether to authorize instituting the OIP” by a leak to the press. Although Respondents helpfully provided more details in their Opposition and Civil Complaint, even considering those details this defense remains unduly vague and even self-contradictory: the leaker, and whether he or she was affiliated with the Commission, is unidentified, and may be impossible to identify; the leak apparently occurred very soon before the actual Commission vote and it is unclear how the Commissioners allegedly learned of it in time to have been influenced; and it is unclear how, under any set of facts, a presumably unauthorized leak could constitute “improper conduct” imputable to the Commission itself. Accordingly, Respondents shall provide a more definite statement of this defense.

Defense No. 25: MDS required.

This defense alleges that the “designation and use of personnel of OCIE” violated certain legal provisions identified in the Opposition. Because the Opposition identifies the specific legal provisions allegedly violated, namely, 17 C.F.R. §§ 200.19b, .19c and 15 U.S.C. § 78p(b), the Division should be able to respond to the claim that these provisions were violated and that the proper remedy is dismissal, provided that Respondents identify the pertinent employees. Although Respondents have helpfully provided more details in their Exhibits, as noted, a reference to the Exhibits is insufficient. Accordingly, Respondents shall provide a more definite statement, which must include an identification of the OCIE personnel at issue.

Order

The Division’s Motion is GRANTED IN PART and DENIED IN PART, as outlined above.

Respondents shall file a More Definite Statement consistent with this Order no later than August 17, 2012.

Cameron Elliot
Administrative Law Judge