Factoids, Alternative Facts, and the Truth

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Urska Velikonja, *Are SEC's Administrative Law Judges Biased? An Empirical Investigation*, 92 **Wash. L.Rev.** (forthcoming), available at SSRN.

When President Trump declares that he had the largest electoral college victory by a Republican since President Reagan, or that but for the 3 to 5 million illegal votes he would have won the popular vote, or that he had the largest inauguration crowd ever, everyone has come to learn that these "alternative facts" are not to be trusted. But when the Wall Street Journal publishes articles purporting to show that securities defendants are considerably more likely to lose when the Securities and Exchange Commission (SEC) sues them in administrative proceedings than when it sues them in court, because of the SEC's "home-court" advantage before its ALJs, people take it seriously. So seriously indeed that the media, scholars, and even judges cite to the articles as established fact. But it's not, and we have Professor Urska Velikonja to thank for establishing that.

To begin, while the brouhaha occasioned by the Journal articles has been centered around the SEC, and largely its enforcement efforts under the now controversial Dodd-Frank Act, the underlying thesis – that defendants do not get justice in administrative proceedings before ALJs, because those ALJs are biased in favor of their employer – would apply government-wide, not just to the SEC. And if given credence, this thesis would undermine what has been an essential aspect of administrative law for more than a century – administrative enforcement subject to judicial review as an alternative to executive actions in court for judicial enforcement. In other words, the stakes are high, and the truth, not factoids, is critical.

Professor Velikonja reviewed every enforcement action between 2007 and 2015. While she found that there had been an increase in SEC filings in administrative forums, still the vast majority of contested actions are brought in court rather than before ALJs. Moreover, most of the increase resulted from an increase in the number of cases which historically had been brought in administrative forums, rather than a switch from cases formerly brought in court now being brought before ALJs. There was an increase in the contested cases brought before ALJs under Dodd-Frank, but the shift was relatively small, from 8% to 18%, meaning that even under Dodd-Frank 82% of the cases were brought in court.

More importantly, Professor Velikonja found no robust relationship between the type of forum and case outcome, contrary to the widely-accepted assertions by the Journal to the contrary. That is, the difference between the SEC's win rates in court and before ALJs was not statistically significant. The fault with the Journal's analysis it turns out was that it did not control for some important independent variables (or predictors, as they are now called). First, the Journal did not control for the subject matter of the action. The SEC's win rate is significantly lower for insider trading and accounting fraud regardless of forum. The Journal also did not control for the nature of the defendant; the SEC's win rate against individuals is notably lower than against companies regardless of forum. By not comparing win rates for similar types of cases and similar types of defendants in the different forums, the Journal was comparing apples to oranges. Moreover, the Journal only considered cases that were decided after a trial, but the vast majority of cases are either settled or decided on motion. In addition, once one corrects for these errors, the SEC's supposed benefit from bringing cases before ALJs disappears. Indeed, in the only category of cases in which the majority were brought before ALJs, broker-dealer cases, the SEC's win rate in court was higher than its win rate before ALJs.

Professor Velikonja's article is a dense, statistical analysis, to which this blog cannot do justice in any real sense. Those with a mathematical or statistical bent will be able to discover a number of other observations which she

uncovers in the course of her study. Here, I am focusing on the rebuttal of the claims that have come to be accepted as common wisdom. And here, her conclusion is unequivocal:

Contrary to the claims advanced by the *Wall Street Journal*, the data analysed do not support the conclusion that the SEC is more likely to win at trial decided by an ALJ than in one decided by a federal district judge once one controls for case category, the nature of the defendant, and the existence of parallel criminal proceedings. Any reported disparities in outcomes in individual years are noise.

At the same time, Professor Velikonja recognizes the limits of her own study. While she has included consideration of a number of independent variables ignored by the Journal, she confesses that two important variables are omitted from her study – case quality and the SEC's perception of case quality. She concedes that it is possible that the SEC files in an administrative forum when it believes it would not win in court. Then, if the win rates remain the same between the cases brought in court and before ALJs, it might suggest that the ALJs are biased or that the SEC has a home-court advantage. The problem is that neither of these variables are easily observable or measured. She also identifies other factors that lead her to conclude that relative success rates between administrative proceedings and court proceedings are a poor measure of fairness in enforcement. Ultimately, Professor Velikonja acknowledges that her study does not prove that the SEC does not have a home-court advantage, only that the Journal article is no evidence that it does. As a result, she fears that notwithstanding the lack of validity of the Journal article, the perception that ALJs supply a lesser form of fairness is likely to persist. She ends by suggesting a few measures that might ameliorate that perception, such as providing for all but the most routine cases to be removable to federal court, a proposal that is actually contained in a current bill before Congress. Nevertheless, she points out that there are significant costs associated with those measures, costs which may well outweigh their benefits.

Professor Velikonja's article does not address the implications of this debate to the use of ALJs generally for administrative enforcement, but there is no doubt that defendants in such enforcement, especially those with the financial ability and incentive to undertake protracted litigation, will seize upon current factoids suggesting ALJs are inherently biased in favor of their agency. After all, the agency hires and pays the ALJs, some of whom may have once worked for the agency, they will say. They will use this argument, as they have already, in courts and Congress in an attempt to eliminate administrative enforcement. They will cite to the recent but burgeoning number of academic articles, using a dubious originalism, to the effect that enforcement by administrative adjudicators is unconstitutional either as a matter of Due Process or Separation of Powers. Lurking behind this, however, is simply a desire to undo effective enforcement of government regulations. It was precisely the need to enhance enforcement that led Congress to provide for administrative enforcement in the first place. Administrative enforcement is necessary because the costs of judicial enforcement impose substantial limits on the number of cases agencies can bring. Once it was thought that the lower cost of administrative adjudication was a benefit to defendants as well; they could mount their defense at a lower cost than in court. But to the extent that the defendants are business entities or executives with deep pockets, they may be happy to accept the greater cost of judicial proceedings, especially if the result will predictably be fewer enforcement proceedings because of the agency's limited budget.

While Professor Velikonja's article may not stem the tide, it is important because it provides truth against an argument based on falsity.

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