Congress Should Change Agency In-House Courts' Lax Evidence Rules

Published in Bloomberg Law (December 13, 2023) by Karin Dryhurst and Jessica Lewis

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WilmerHale partners say the evidentiary standards that in-house agency courts use are more relaxed than the Federal Rules of Evidence, leading to questions of fundamental fairness in the results. Congress should change this, they write.

In its much-anticipated ruling in *SEC v. Jarkesy*, the US Supreme Court will soon decide whether the Seventh Amendment right to a jury trial applies in securities fraud cases where the Securities Exchange Commission seeks penalties.

A decision in favor of respondent George Jarkesy could have significant consequences, as many enforcement agencies have used their own in-house proceedings to levy sometimes ruinous penalties against alleged wrongdoers.

Although the issue in *Jarkesy* is whether a defendant is entitled to have a jury decide the facts, some of the discussion at oral argument last week had more to do with the rules that apply in those in-house forums.

In response to one of the justices, counsel for Jarkesy noted that the federal rules of evidence don't apply in agency proceedings. It's a point that should get more attention—as agencies across the federal government, including the SEC, the Board of Immigration Appeals, the Consumer Financial Protection Bureau, and the Federal Trade Commission, have their own more informal rules of evidence that can dramatically affect how the facts are determined.

Congress enacted these more lenient rules decades ago, before agencies were given the authority to seek massive civil penalties in in-house proceedings. Research from Northern Illinois University College of Law and other studies have shown that the SEC and banking agencies have sought increasingly steep penalties.

The CFPB can seek up to a maximum of $1 million per day for certain violations, according to statute. And agencies in recent years sought millions of dollars (and in some cases, more than $15 million) against a single individual.

One of the policy reasons offered for the more relaxed approach, in addition to efficiency and simplicity, is that it will lead to more information and therefore a more informed result.

Agency rules therefore tend to be a one-way ratchet in favor of more evidence with fewer guardrails. Specifically, if evidence is admissible in federal court, it's also admissible in an agency proceeding; but many forms of evidence may be admitted in an administrative proceeding, even if that same evidence would be inadmissible in federal court.

But, as many have noted in our supercharged information economy, more isn't always better. For example, the $1 million a day CFPB penalty kicks in when the defendant "knowingly" violates the law. In federal court, there are limitations on what evidence lawyers can use to show someone's state of mind.

One of the requirements is that a regular person can't testify about what they think the defendant was thinking—because we don't trust people to be mind-readers. So, if an agency allows witnesses to opine that an alleged wrongdoer knew what they were doing was wrong, the decision-maker may technically have received more information, but it doesn't necessarily follow that it will lead to a more informed result.

As another example, hearsay—something someone says out of court—is generally not allowed in federal court, with some exceptions. For example, Person 1 generally can't testify in federal court that they heard Person 2 say they saw the defendant do a bad thing.

Instead, Person 2 has to come and tell the court what they saw. The reason is that, without the actual witness there, there is no way to assess whether that person is credible and telling the truth.

But in agency proceedings, there's no "automatic" rule against hearsay so long as the agency—the same agency that's coming after the defendant—determines the statement is otherwise "reliable."

In another example, certain documents previously created by the agency are often admitted without any further consideration. In addition to acting as prosecutor, judge, and jury, the agency is also a witness in its own case.

There are of course some limitations. In some instances, agencies look to the federal rules for guidance. Otherwise, agencies are supposed to ensure admitted evidence be, at a minimum, "relevant, material, and reliable."

And the Supreme Court requires that agency proceedings be "fundamentally fair," and not based on "suspicion" and "speculation." But the evidence allowed in some proceedings raises serious questions about whether at least some agencies allow "speculation" to substitute for reliable evidence.

On top of that, there are questions about the independence and expertise of some administrative law judges. ALJs may move among agencies whose subject areas bear little in common, from an agency like the Social Security Administration to one like the SEC; it's hard to see how an ALJ on that path has developed expertise with securities markets.

In practice, federal judges in a bench trial sometimes relax evidence rules because judges view themselves as able to place more or less weight on certain evidence than a jury

Nonetheless, federal judges must start from the federal rules of evidence, and misapplication of those rules can result in reversal. Although there is a right to appeal agency decisions in federal court, that review generally does not result in new fact finding.

These issues can result in proceedings that fail to meet common expectations of fairness—where the end result can be millions of dollars of penalties imposed on an individual barred from working in their industries—and therefore potentially unable to pay them.

Regardless what the Supreme Court decides, Congress—as the entity that made these rules—can and should step in.

The case is SEC v. Jarkesy, U.S., No. 22-859, argued 11/29/23.

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