Testimony in Opposition to SB 2296

North Dakota Securities Commissioner Karen Tyler

Senate Judiciary Committee

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Good Afternoon Chair Larson and members of the Committee, I am Karen Tyler, the state securities commissioner, and I oversee the North Dakota Securities Department.

My testimony today is in opposition to SB 2296, a bill that implements sweeping and detrimental changes to what is currently an effective system of adjudication for contested securities department enforcement matters – a system in which the Administrative Law Judge is entirely independent, the adjudication is fair and balanced, subject matter expertise can be considered as appropriate, the statutory authority of the Commissioner is preserved, and due process is supported for all parties.

Department Background

The Securities Department is a regulatory agency that serves the citizens of North Dakota through the administration and enforcement of the North Dakota Securities Act (10-04), the North Dakota Commodities Act (51-23), and the Franchise Investment Law (51-19).

The Department's primary regulatory policy objective is investor protection. The laws and rules we administer protect investors who are willing to take on risk and put their money to work in our country's capital markets. Among other responsibilities, and pertinent to this bill, the Department:

1) regulates the capital formation process.
2) registers and regulates the conduct of securities industry firms and professionals who want to do business in the state.
3) performs conduct focused examinations of broker-dealer and investment adviser firms and professionals.
4) investigates investment fraud and takes enforcement actions as necessary and appropriate, and we also make criminal referrals and support criminal cases. The majority of our resources are dedicated to this enforcement function.

For purposes of my testimony today, my remarks will focus primarily on the Department's investigative work involving investment fraud and the victimization of North Dakota investors.

It is worth noting that in the vast majority of the Securities Department's enforcement actions, the facts underlying the Department's findings and conclusions are not in dispute. Procedurally, after an investigation or examination and upon the finding of a violation of the Securities Act, the Commissioner issues an order to the respondent that is subject to the Securities Act and rules thereunder. Respondents typically either do not contest the Commissioner's order and it becomes a final order by statute (NDCC 10-04-16), or they negotiate a settlement and final disposition via a Consent Order.

If an investigation involves the conduct of a registered financial professional who works for a registered investment firm, the likelihood of a resolution that brings relief to the harmed investor without an administrative hearing is high. Investment firms are largely cooperative and interested in correcting conduct that has harmed a client. Our securities laws provide strong enforcement mechanisms such as the potential for revocation of a firm or professional's registration, the ability to assess significant civil penalties per violation, and the ability to order the

return of the investor's funds plus interest. These are authorities that are exceedingly effective in resolving cases involving registered firms and professionals.

If, however, an investigation involves an unregistered person with no affiliation to a brokerage firm or investment adviser firm, or an unregistered person selling unregistered securities to raise money for a company that may be operating a fraud, it is this type of case that will more likely result in the request of an administrative hearing and the appointment of an ALJ to preside.

Securities Department Cases Before an ALJ

When the Securities Department requests the designation of an ALJ, under current law (N.D.C.C. § 28-32-31) we can request to: 1. Have the ALJ conduct the hearing and issue recommended findings of fact, conclusions of law and a recommended order; 2. Have the ALJ conduct the hearing and issue findings of fact, conclusions of law, and a final order; or 3. Serve as a procedural ALJ with no recommended decision. SB 2296 appears to eliminate the recommended order alternative, thereby impairing the authority currently vested in the Securities Commissioner under NDCC 10-04-16 of the Securities Act.

It is important to clarify that in a hearing related to an order of the Securities Commissioner, an Administrative Law Judge is no more under the "supervision" of the agency attorney who appears before them, than a district court judge or a Supreme Court justice would be. Regardless of the selection on the finality of the order, the ALJ conducts a wholly independent and impartial hearing and issues a reasoned and timely decision. Due process for the agency and all parties appearing is further supported by a right to appeal any decision by the aggrieved party to the District Court, and further to the North Dakota Supreme Court if warranted.

Securities Case Example

In contested securities cases for which an Administrative Law Judge has been appointed, it is not uncommon that the related investigation has been records intensive, fact patterns are highly complex, applicable securities law nuanced, and a claim of federal securities law pre-emption introduced.

Very recently the Securities Department brought an action that resulted in the appointment of an ALJ to preside over an administrative hearing in a matter demonstrative of these case characteristics. In early 2021, based on a complaint by a North Dakota resident, the Department began an investigation into the

funding and development of a hemp processing plant to be built near Kendall, Wisconsin. Through investigative efforts, we determined that over $1.1 million dollars of investor money had been raised illegally by a North Dakota based promoter and used to pay an upfront fee in a fraudulent “fee for funding scam”. There were 9 individual investors who invested money in exchange for an investment contract instrument, based on the representation that their money was being used to cover up-front closing costs on a supposed $250 million loan financing package being offered by an Atlanta, GA based money broker that would fund construction of the project. All investor funds, $1.1 million, were wired to the so-called “money broker”. 2 years later, no financing package has materialized, and investor funds have not been returned. Throughout the course of this investigation, hundreds of pages of documents were secured and reviewed, including bank statements and supporting documents, promissory notes, private placement memorandums, as well as extensive communications between the investor victims and fraudulent actors.

When the Department requested the ALJ to preside over the hearing the first option outlined earlier in my testimony was selected. (Recommended Findings, Conclusions, Order) This meant procedurally that after the ALJ presided over and conducted the hearing, and after evidence was introduced and arguments were

made, the Department would receive from the ALJ a recommended order to adopt or amend and then the Commissioner would issue the final signed order. The Department's enforcement attorneys appearing before the OAH ALJ did not "supervise" the adjudicative process. The ALJ ran the hearing much as a District Court Judge handles a bench trial. The Department did not supervise the ALJ or influence the decision, but rather at the end of the proceedings, the Department has the ability to amend the findings of fact and conclusions of law to ensure that no details, facts or law were left out. This review process by the agency ensures a complete record to support a well-reasoned decision by an ALJ on a complex esoteric subject matter.

Of course any such amendment must still be contained in the record of the administrative hearing. The Department cannot simply unilaterally change the outcome of the proceeding without any support, but rather utilize the evidence that was admitted, and the testimony taken to clarify the decision and bolster the reasoning. In the matter at hand, the ALJ found in favor of the Department but did not specify the relief granted. In addition to confirming the Commissioner's earlier Order that the Respondents were liable to the investors for the return of their funds, with interest, the ALJ wrote "Respondents are jointly and severally liable for and shall pay a civil penalty an amount determined appropriate by the

Securities Commissioner based on the violations described above." Based on the findings of fact and conclusions of law, the Department will now use its securities law expertise, historical case knowledge, as well as the specific facts of the case, to determine what relief should be ordered. This allows the Department to ensure that securities law is appropriately followed and the relief is consistent and fair.

Chevron Deference Test

North Dakota case law is clear that when the North Dakota Supreme Court reviews the decision of an administrative agency, deference is given to the agency decision.[1] This legal doctrine that the North Dakota Supreme Court relies on, is derived from the landmark 1984 US Supreme Court decision in the matter of Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc, which created what is now known as the Chevron deference test.

[1] *See, for example, Delorme v. N.D. Dep't of Human Services*, 492 N.W.2d 585 (N.D. 1992). "This Court reviews the Department's decision to suspend a person's driving privileges under the Administrative Agencies Practice Act, N.D.C.C. ch. 28–32. Painte v. Dir., Dep't of Transp., 2013 ND 95, ¶ 6, 832 N.W.2d 319. When an administrative agency's decision is appealed from the district court, we review the agency's decision. Id. Generally, '[c]ourts exercise limited review in appeals from administrative agency decisions, and the agency's decision is accorded great deference.' Id.", *McCoy v. N. Dakota Dep't of Transp*., 2014 ND 119, ¶ 6, 848 N.W.2d 659, 662–63; and "However, we give some deference to a reasonable interpretation of a statute by the agency responsible for enforcing it, and give appreciable deference to agency expertise if the subject matter is highly technical. Consol. Tel. Coop. v. W. Wireless Corp., 2001 ND 209, ¶ 7, 637 N.W.2d 699.", Grey *Bear v. N. Dakota Dep't of Hum. Servs*., 2002 ND 139, ¶ 7, 651 N.W.2d 611, 614.

Under Section 2 of the bill, the proposed legislation appears to place restrictions on judicial decision making that would be in conflict with the Chevron deference test, and further, it appears to mandate a new legal standard that could have the effect of creating bias in favor of a respondent. In Securities Department cases this could result in a mandated deference to a respondent found by the Commissioner to have engaged in securities fraud and misappropriation of investor funds. I respectfully ask the committee to reject this requirement to favor the individual liberty of one party, who may have stolen the financial freedom of another.

In closing my remarks in opposition to this bill, I would reiterate my opening comments – this is a bill that brings sweeping and detrimental changes to what is currently an effective system of adjudication for contested securities department enforcement matters – a system in which the Administrative Law Judge is entirely independent, the adjudication is fair and balanced, subject matter expertise can be considered as appropriate, the statutory authority of the Commissioner is preserved, and due process is supported for all parties.

I respectfully request a “do not pass” on SB 2296.