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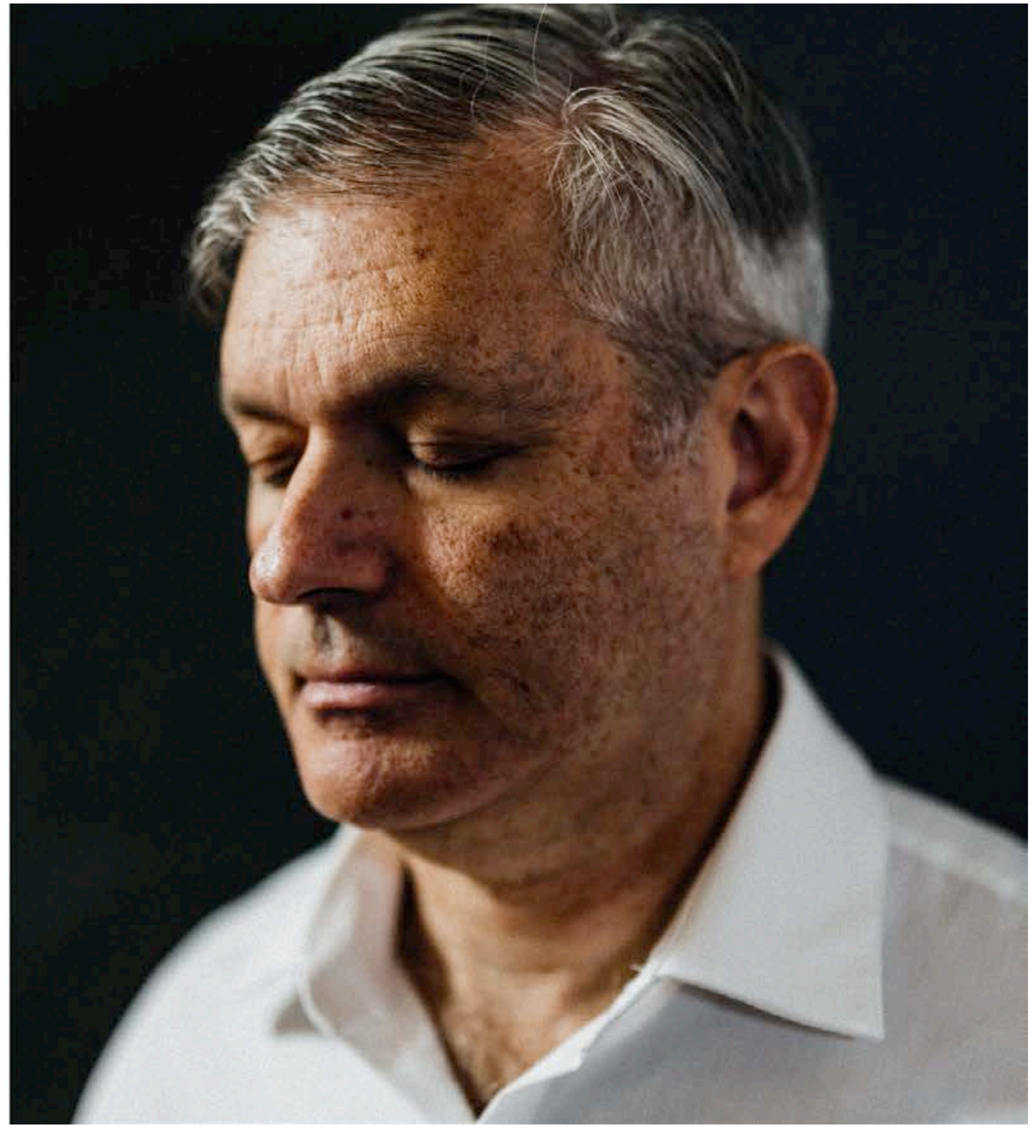
By GRETCHEN MORGENSON MAY 4, 2017



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On its face, it seemed like a simple case. Eric D. Wanger, according to regulators, had done things a money manager shouldn't do.

Over nearly three years, they said, Mr. Wanger made 15 improper trades for a fund he oversaw at his Chicago firm, Wanger Investment Management. The trades, in a handful of small, illiquid stocks, were said to have inflated the fund's performance and generated extra fees for Mr. Wanger.

The supposedly ill-gotten gains were computed to be less than $2,270. The cost to Mr. Wanger has been much higher. He had to close both his investment management firm and a family office that advised dozens of clients, with $300 million in assets, a company he had borrowed against his home to set up. Nearly five years later, he is still barred from the business.

His penalty — part of a settlement that he thought would allow him to quickly resume his practice — was exacted by the Securities and Exchange Commission, after his case was brought in a court system operated by the commission itself.

The S.E.C. is not the only federal agency that uses internal courts to adjudicate enforcement matters. Some 30 others, including the National Transportation Safety Board and the Social Security Administration, also do it. The idea behind these systems is that judges who have deep expertise in their fields will oversee cases more efficiently than those in federal courts. Limiting discovery and other procedural actions is also intended to streamline the process.

Among cases that go to a hearing, the S.E.C. prevails more often than it does when it litigates matters in federal courts. To critics, this indicates that the S.E.C.'s system is stacked in its favor. The commission says the system is not only expedient but also fair and just.

Mr. Wanger's case is just one of dozens pending before the commission's judges. But in the aftermath of the 2008 economic crisis, when few high-level executives of major banks faced S.E.C. action, the pursuit of Mr. Wanger for the financial equivalent of a foot fault in tennis is noteworthy.

"I appreciate the fact that people wanted scapegoats after the great recession," Mr. Wanger, 54, said in a recent interview. "I'm never going to get my business back, but I want my reputation back. I want the same right as everyone else in the United States to go out and make a living."

It is only right, of course, that violators of securities laws bear the consequences of their infractions. But had Mr. Wanger been able to battle the S.E.C. in federal court, he would have been better able to defend himself, his lawyer said. The commission's internal judges have greater sway in their courtrooms than judges overseeing proceedings that adhere to the rules of due process.

S.E.C. judges can disallow the introduction of expert witness testimony on behalf of defendants, and reject requests for information about government witnesses from the other side. Taking depositions and conducting discovery as part of a defense are also limited in these courts.

Critics of this system say it stacks the deck against those who may not have the means to defend themselves aggressively. And while rich and influential firms that get into regulatory scrapes can bill their legalcosts to shareholders and return quickly to business, individuals often can't.

Mr. Wanger, who believes the case against him was brought at the urging of a rival in a corporate power struggle, ultimately settled the case without admitting or denying the allegations. He paid a penalty of $75,000 as well as the amount of the management fees in question, with interest. He estimates that he has paid $1 million or more in legal fees.

Crucially, the settlement barred him from the securities industry, with the right to reapply after a year. But his attempts at readmission have been rejected. In February, an S.E.C. enforcement official told Mr. Wanger's lawyer that his unit was going to recommend to the commission that Mr. Wanger remain barred. The reason: he had not demonstrated that it would be in the public interest for him to rejoin the industry.

The S.E.C. declined to comment on Mr. Wanger's case.

Mr. Wanger is not alone in questioning the commission's actions against him. Joseph A. Grundfest, a former S.E.C. commissioner who is now a professor of law and business at Stanford Law School, does as well.

Mr. Grundfest, an acquaintance of Mr. Wanger, tried to provide expert testimony, pro bono, to the S.E.C. on his behalf. In Mr. Grundfest's view, Mr. Wanger received no material financial benefit from the actions the commission attributed to him, and no reasonable investor would have considered the alleged improprieties to be material.

In an interview, Mr. Grundfest said he had begun with the assumption that Mr. Wanger improperly executed the trades at the heart of the case, even though that was only an allegation.

Still, he finds the case puzzling. Given the scarcity of the regulators' resources, the decision to spend almost three years investigating what turned out to be 15 improper trades is remarkable.

"The S.E.C. spends how many hundreds of thousands of dollars pursuing this guy for alleged violations that would have moved his portfolio by 85 one-hundredths of one percent?" Mr. Grundfest said. "I know the S.E.C.'s response is 'We go after violations where we find them.' But, really? How smart is that? Why are so few senior executives prosecuted and meanwhile Eric Wanger's career is destroyed?"

'A Facade of Justice'

The number of cases that go through the S.E.C.'s internal court has increased in recent years, at the direction of Congress in the Dodd-Frank financial reform act, which authorizes the commission to bring almost any case before its own judges rather than those in federal courts. Some 84 matters were pending before commission judges in the fiscal year that ended last September, up from 33 pending matters in fiscal 2009.

The S.E.C. employs five judges, who hold public hearings, issue decisions and impose sanctions, including monetary penalties. They can also revoke securities licenses, as the judge in the Wanger case did. Most matters are settled before they are concluded.

For the five years ending in 2016, the agency said it had won an average of 89 percent of the time in matters heard in its internal courts, versus 76 percent of the time in trials in district courts.

The agency argues that those who are unhappy with the in-house court rulings are free to appeal them. But initial appeals must go before the full commission itself; to prevail there is unlikely, as it would require the S.E.C. to overrule its own enforcement division and internal judges.

If unsuccessful in appealing to the commission, a respondent can go before a circuit court of appeals. But these courts are typically hesitant to question the findings of administrative law judges, who are considered experts in their fields.

Mounting such appeals also requires the financial means, something individuals often do not have.

In any case, successful appeals have been rare.

"The S.E.C. creates a facade of justice while unfairly prejudicing respondents, particularly individuals who often barely have the resources for an effective defense," said Lewis D. Lowenfels, a securities lawyer in New York and an adjunct professor at

Seton Hall University School of Law. "Never mind the additional resources required to pursue the narrow avenues of court review, which the S.E.C. contends makes the entire process legal."

Two cracks have recently emerged in the S.E.C. system. One occurred in December, when the United States Court of Appeals for the 10th Circuit ruled that the commission's in-house judges are not constitutionally appointed, and therefore hold office in violation of the Appointments Clause of the Constitution. The Supreme Court may take up the case, and potentially rule on the constitutionality of the internal system.

In February, the United States Court of Appeals for the District of Columbia Circuit said it would reconsider a challenge to the S.E.C.'s use of in-house judges heard by a three-judge panel that ruled in favor of the commission last August. That hearing is scheduled for May 24.

Some in Congress have looked at the system and found it lacking. The Financial Choice Act, a Republican-backed bill being considered by the House that would undo much of the Dodd-Frank Act, would allow respondents to remove their cases from the S.E.C. courts and bring them before a federal judge.

Thomas V. Sjoblom, the lawyer currently representing Mr. Wanger, called the system unfair and said that Congress should fix it. "This lack of due process has really got to be solved, especially when you're talking about small entrepreneurs," Mr. Sjoblom said. "If you're going to accuse these people of fraud, they need to have the right to remove the case to federal court."

An Ugly Dispute

To this day, Mr. Wanger says he doesn't know why the S.E.C. came after him. But he has a suspicion: because of a shareholder rights battle he waged against a troubled company whose stock he owned.

The company was AltiGen Communications, a maker of telephone systems and call center products in San Jose, Calif. In 2006, seeing potential in the floundering company, Mr. Wanger started buying its shares. By January 2007, he had a seat on the AltiGen board, and his Wanger Long-Term Opportunity Fund was one of the company's largest shareholders.

Mr. Wanger was no Wall Street titan famous for rattling corporate cages. He did, however, have stock picking in his blood; for decades his father, Ralph Wanger, had managed the Acorn Fund, a respected and successful mutual fund specializing in small companies' shares.

The younger Mr. Wanger grew up in and around Chicago, and in 1985 earned a Bachelor of Science in mathematics from the University of Illinois at Urbana-Champaign. He began providing information technology consulting services to businesses large and small. In 1999, Mr. Wanger received a law degree from Stanford; while there, he had been a founder of the Stanford Technology Law Review.

He moved back to Chicago and became an investment analyst for a large private equity firm, where he focused on technology and communications companies.

In 2002, Mr. Wanger opened Wanger Investment Management, the firm that oversaw the Long-Term Opportunity Fund. At its peak, it had $20 million under management. In 2009, Mr. Wanger started Wanger OmniWealth L.L.C., a multifamily office advising 40 clients with $300 million in assets; he employed 11 people.

After more than a year on the board of AltiGen, Mr. Wanger set out to shake things up. In the fall of 2008, the company ignored a lucrative buyout offer. On Jan. 7, 2009, with its stock languishing at around $2, Mr. Wanger told AltiGen's lawyers, the powerful Silicon Valley firm Wilson Sonsini Goodrich & Rosati, that the company needed to make significant changes; he also told them he was considering taking the company private.

Things got ugly fast. The next day, in a filing with the S.E.C., AltiGen said Mr. Wanger had failed to file certain stock ownership forms on time the previous year; the company also said it would not nominate him for re-election to the board.

Mr. Wanger's filing lapse was not exactly news. A month earlier, he had reported the error to the AltiGen board and corrected the omissions. AltiGen later stated that Mr. Wanger's filing failure was inadvertent.

Still, under pressure to leave the board, Mr. Wanger resigned on Jan. 26, 2009. He continued to buy and hold AltiGen shares.

An AltiGen official and Issac Vaughn, the former Wilson Sonsini lawyer who represented AltiGen, did not respond to requests for comment.

In late 2009, some of Mr. Wanger's clients began pulling their money from his fund. He didn't know why, and only learned later that his customers had received calls from investigators at the S.E.C. To meet his clients' redemptions in the Long-Term Opportunity Fund, Mr. Wanger started selling his AltiGen shares and other holdings.

It wasn't until February 2010, about a year after Mr. Wanger had picked the fight with AltiGen, that an official in the Chicago office of the S.E.C. told him that he and his firm were under investigation. The commission asked him to produce documents involving AltiGen.

"The first thing they did before they reached out to me was call my clients," Mr. Wanger said. "They destroyed my business before I even knew I was under investigation."

Futile Arguments

Six months later, the S.E.C. told Mr. Wanger that it intended to bring an enforcement case against him. The findings of its two-and-a-half-year investigation emerged on Dec. 23, 2011, when the commission filed a formal order against Mr. Wanger. Its central contention: Over almost three years, he had traded improperly in a handful of stocks. The order also mentioned Mr. Wanger's failure to file ownership forms in AltiGen stock on time.

At first, Mr. Wanger fought back. He soon learned how difficult it was to defend himself before an S.E.C. administrative law judge.

In January 2012, his lawyer at the time asked for a dismissal of the case for two reasons: The S.E.C. had not proved its allegations, and had also missed a deadline when filing its order against Mr. Wanger. In addition, he asked the commission to provide Mr. Wanger with documents the government had generated during the investigation.

Brenda P. Murray, the chief administrative law judge who was hearing the case, rejected all of the arguments. She denied the document request, saying it was "unreasonable and excessive in scope," and said the S.E.C.'s filing was not late because it had received an extension in the case, because of its complexity.

Asked by Mr. Wanger's lawyer to explain why a case involving 15 trades was complex, the S.E.C. declined.

Then there was the matter of expert testimony. A lengthy opinion filed by the commission's expert said Mr. Wanger "stood to benefit substantially" from his improper trading. Mr. Grundfest, the former S.E.C. commissioner and Stanford Law professor, disagreed and offered to respond.

The opinion of the expert, Mr. Grundfest wrote, was "entirely unsubstantiated by even the most rudimentary form of quantitative analysis." While accepting the S.E.C.'s findings, Mr. Grundfest said that the effect of the trading on Mr. Wanger's financial returns was trivial: $2,269.81 over 33 months, or less than $69 per month.

But the S.E.C.'s enforcement division argued that Mr. Grundfest's opinions should be barred from the proceedings. Yes, Mr. Grundfest's background was impressive, the commission's lawyers said, but "such credentials are not a license to lecture this tribunal about securities laws."

For Mr. Wanger, this was the last straw. His lawyer advised him to settle the case because without subpoenas or witnesses, they would lose. "I couldn't get anyone to look at the facts," Mr. Wanger said. "What actually occurred ceased to be relevant so early on in the process."

On July 2, 2012, he settled the case without admitting or denying the allegations. Although he hated the idea, he said he thought he would be back in business shortly after his one-year suspension expired.

Almost five years later, Mr. Wanger remains barred. Fourteen former clients have written letters to the S.E.C. attesting to Mr. Wanger's character and urging the agency to readmit him; the commission has declined. On Feb. 22, an enforcement official told Mr. Wanger that the unit intended to recommend that the commission deny the money manager's application because he had failed to show that his re-entry would be in the public interest.

Although Mr. Wanger was given a one-year suspension, with the right to reapply, his regulatory record administered by the Financial Industry Regulatory Authority characterized him until recently as permanently barred. He had tried unsuccessfully to get Finra to correct this error. After a recent call from a reporter about the discrepancy, the authority changed his status to simply barred.

Years after Mr. Wanger settled his case, the S.E.C. continued to monitor him. Phoebe Telser, Mr. Wanger's mother, said she received a phone message in July 2014 from a lawyer at the agency's Chicago office asking questions about her son.

"This was two years after the settlement, so why were they fishing?" Ms. Telser asked in an interview. "Knowing about Eric's situation, it felt like the McCarthy hearings. It frightened me." Ms. Telser said she had returned the call, but never heard back.

Mr. Wanger, who now calls himself the $2,200 Man on a website he has created, said his experience with the S.E.C.'s in-house court system did not feel like he was in America. "I've spent the last seven years fighting for the right to defend myself in a real court in front of a real judge," he said. "Constitutional rights have no meaning unless you're willing to extend them to people you don't necessarily like."

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