Client Update
Eleventh Circuit Halts Parallel Federal Litigation Against the SEC's In-House Judges

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On June 17, the Eleventh Circuit joined several other circuits in ruling that respondents who face ongoing or prospective administrative proceedings by the U.S. Securities and Exchange Commission ("SEC" or "Commission") cannot turn to federal district courts to mount constitutional challenges to the SEC's authority prior to the SEC proceeding. In *Hill v. SEC* , the Eleventh Circuit held that, in light of the comprehensive review scheme under the Securities Exchange Act of 1934 ("Exchange Act"),[1] Congress intended for respondents to raise and exhaust constitutional claims in the administrative forum before taking their arguments up with a federal court of appeals.[2] Joining the District of Columbia, Seventh, and Second Circuits, the Eleventh Circuit in *Hill* is the fourth federal appellate court to find that district courts cannot hear preenforcement challenges to the SEC's administrative in-house courts and likely marks the end of a legal debate that has drawn significant public attention over the past several years.

CONSTITUTIONAL CHALLENGES TO ADMINISTRATIVE PROCEEDINGS

The Exchange Act vests the SEC with discretion to bring actions either by filing a complaint in federal court or by issuing an order instituting administrative proceedings in an SEC in-house court. In the latter case, claims by the SEC's Enforcement Division are authorized by the Commission, which delegates the review to an internal Administrative Law Judge ("ALJ"). The widely covered *Hill* case arose during an aggressive upsurge in the SEC's use of administrative proceedings under the leadership of SEC Chair Mary Jo White. The SEC had perhaps most noticeably stepped up its reliance on administrative proceedings in insider trading cases like *Hill*, in contrast to the agency's almost uniform practice

[1] 15 U.S.C. § 78y.

[2] *Hill v. Secs. & Exch. Comm'n*, No. 15-13738 (11th Cir. June 17, 2016).

prior to 2014, of litigating such cases in district court.[3] This recent trend sparked significant criticism of the SEC's administrative process and ALJs,[4] which detractors argued unfairly advantaged the SEC from a procedural standpoint (for example, by operating outside of the Federal Rules of Evidence and the right to a jury trial) and in overwhelmingly ruling against respondents and in favor of the SEC.

In *Hill*, the SEC instituted proceedings against real estate developer Charles Hill for purchasing stock in a company weeks before it announced a merger. When the SEC scheduled a hearing before an ALJ, Hill filed motions for summary disposition both on the merits and on the grounds that the in-house hearing was unconstitutional. His constitutional argument was threefold, and echoed arguments that several respondents have raised in the past: First, per the Supreme Court's 2010 ruling in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, the existence of two layers of tenure protection for ALJs violates Article II's removal provisions.[5] Second, the manner in which the SEC chooses an administrative forum violates the non-delegation doctrine under Article I. Third, the SEC's ability to bring enforcement actions in an in-house court deprived Hill of his Seventh Amendment right to a jury trial.

Days after the ALJ denied Hill's motion, opining in part that ALJs have no authority to assess the constitutionality of the Exchange Act, Hill filed a complaint and motion for a temporary restraining order in the U.S. District Court for the Northern District of Georgia. His complaint repeated his previous arguments and added a fourth claim that the ALJs, operating as inferior officers under Article II, were appointed in contravention of the Appointments Clause. The district court granted Hill's motion and a similar motion by investment

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[3] The number of insider trading actions brought annually as administrative proceedings increased from 2% in 2013 to 23% in 2014. Sara Gilley, *SEC Focus On Administrative Proceedings: Midyear Checkup*, Law360 (May 27, 2015), *available at* http://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup.

For Debevoise's previous coverage of this trend, including summaries of relevant actions, *see* Debevoise & Plimpton LLC, "SEC Ramping Up Use of Administrative Proceedings in Insider Trading Cases," *Insider Trading & Disclosure Update* vol. 2.1, pp. 15-16 (Jan. 2015), *available at* http://www.debevoise.com/insights/publications/2015/01/insider-trading-and-disclosure-update.

[4] In addition to criticism by the press, judges, and the defense bar, the SEC's increased use of its administrative forum inspired the "Due Process Restoration Act," H.R. 3798, 114th Cong. (as introduced Oct. 22, 2015), a bill that would authorize a respondent to terminate an administrative proceeding by the SEC and require the SEC to bring a civil action instead. As of this writing, the bill remains pending in the House of Representatives.

[5] *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

adviser Gray Financial Group, which had preemptively filed Article II claims under the threat of a potential administrative proceeding. In both instances, the district court held that it had jurisdiction to hear the claims, that ALJs' appointments likely contravened Article II, and that defendants were entitled to injunctive relief.

THE ELEVENTH CIRCUIT'S DECISION

The SEC appealed the district court's rulings to the Eleventh Circuit, which vacated the injunctions and instructed the district court to dismiss both cases for want of jurisdiction. Reviewing the text of the Exchange Act, the court explained, "We see no indication that Congress intended to exempt the type of claims the respondents raise here from the review process it created."[6] The court went on to describe the Exchange Act's comprehensive administrative review scheme: The ALJ issues factual and legal findings, which may then be appealed to or reviewed *sua sponte* by the Commission itself. The Commission has broad, court-like review powers to affirm, reverse, modify or remand the proceedings below. At the conclusion of the process, the Commission issues a final order, which the respondent may then take up with a federal Court of Appeals. The statute also outlines the extent of the appellate court's authority to consider new arguments, reject factual findings, remand or issue a stay. The court pointed in particular to "the detail in § 78y [which] indicates that Congress intended to deny aggrieved parties another avenue for review," and the fact that the statute "cover[s] all final Commission orders without exception."[7]

It was thus "fairly discernible," the court concluded, that Congress intended the respondents' claims to be resolved in the first instance via administrative proceedings, the final result of which could then be appealed to a federal appellate court. The court rejected the respondents' arguments that this process should not be applied to their particular type of claims: "Enduring an unwanted administrative process, even at great cost, does not amount to an irreparable injury on its own. . . . Whether an injury has constitutional dimensions is not the linchpin in determining its capacity for meaningful judicial review."[8] It further found that any discretion built into the statute to bring claims in federal court was granted solely to the government, and that administrative fact-finding tools, "although less robust than those provided by the Federal Rules of Civil Procedure, do not leave . . . respondents without a meaningful avenue to develop the record."[9] Because the

[6] *Hill*, No. 15-13738 at 3.

[7] *Id.* at 16.

[8] *Id.* at 22–23.

[9] *Id.* at 31–32.

Exchange Act outlined a comprehensive process that allowed for meaningful review of all final Commission orders, the court concluded that "the respondents' claims are of the type Congress intended § 78 to govern."[10] The decision thus requires Hill and Gray Financial Group to raise their claims before the ALJ and subsequently the Commission, and only at the conclusion of that process can they bring those claims to a federal Court of Appeals.

THE FUTURE OF CONSTITUTIONAL CHALLENGES TO ALJS

The Eleventh Circuit ruling falls in line with recent decisions by the District of Columbia Circuit,[11] Seventh Circuit[12] and Second Circuit.[13] The Eleventh Circuit ruling followed closely this month's ruling in *Tilton v. SEC*, which attracted significant coverage due to the Second Circuit's leading role in adjudicating SEC enforcement cases. In *Tilton*, the Second Circuit likewise concluded that "Congress intended the appellants' Appointments Clause claim to be reviewed within the SEC's exclusive statutory structure," and that "the appellants must await a final Commission order before raising their Appointments Clause claim in federal court."[14]

A case awaiting review by the Fourth Circuit is currently the only remaining potential for a Circuit split on this issue.[15] However, the string of rulings in the SEC's favor suggest that this issue is now close to being settled. Accordingly, although the Circuit court cases on preenforcement review by federal district courts do not address or resolve the underlying constitutional challenges to the SEC's use of its administrative forum, these and other respondents in SEC enforcement actions will have to wait until they exhaust the administrative process before litigating their constitutional objections to that process.

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Please do not hesitate to contact us with any questions.

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[10] *Id.* at 37.

[11] *Jarkesy v. Secs. & Exch. Comm'n*, 803 F.3d 9 (D.C. Cir. 2015).

[12] *Bebo v. Secs. & Exch. Comm'n*, 799 F.3d 765 (7th Cir. 2015), *cert. denied*, 136 S. Ct. 1500 (2016).

[13] *Tilton v. Secs. & Exch. Comm'n*, No. 15-2103, 2016 WL 3084795 (2d Cir. June 1, 2016).

[14] *Id.* at 11.

[15] *Bennett v. Secs. & Exch. Comm'n*, No. 15-2584 (4th Cir., appeal filed Dec. 28, 2015).