

Axon, Gibson, Jarkesy: Continuing Challenges to SEC's Administrative Citadel

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Earlier this month, the U.S. Supreme Court issued a procedural decision that has the potential to dismantle the Securities and Exchange Commission's ability to litigate cases administratively. On April 14, 2023, the Supreme Court ruled in a consolidated opinion in *Axon Enterprise Inc. v. Federal Trade Commission* that certain constitutional challenges to SEC administrative enforcement actions can be brought directly in federal district court. The Supreme Court thus permitted respondents to bypass the in-house agency adjudication process and expedite federal judicial review of constitutional challenges to the agency's proceedings. For decades, the SEC Enforcement Division has opted to use the SEC's in-house administrative law judges when the case would not warrant or support a federal district court case. This in-house ALJ process was instituted in the late 1960s. Arguably, the in-house expertise of the securities markets and the securities industry provided a more favorable forum in which sophisticated securities law issues could be litigated by those in the know. It was a worthy idea. But the system has received increased scrutiny as the SEC enforcement staff increasingly has used it to "forum shop" to get the resolution they wanted. Michelle Cochran, the subject of an SEC in-house administrative enforcement proceeding in *Axon*, has had a long and foreboding battle with the SEC. In 2016, she was charged with aiding and abetting her former employer's alleged failure to complete certain auditing functions under SEC standards. She represented herself pro se. The ALJ before whom she appeared warned her that he never had ruled against the SEC enforcement staff. In 2017, she lost her case and was banned from practicing as an accountant before the SEC for five years. However, the Supreme Court's 2018 decision in *Lucia v. SEC*, which forced the agency to remove all of its ALJs and reappoint the judges in accordance with the appointments clause of the Constitution, changed Cochran's prospects. The *Lucia* decision required many cases to be heard over again. Therefore, two years after her administrative proceedings began, Cochran was assigned a constitutionally appointed ALJ to rehear her case. But Cochran had had enough. Rather than going back through the preordained ALJ process, she filed suit in federal court, seeking an injunction against the SEC. The U.S. District Court for the Northern District of Texas dismissed Cochran's complaint for lack of subject matter jurisdiction in light of the

statutory review scheme requiring the subject of a proceeding to first appeal an ALJ's decision to the commission, and only then to the appeals court. On rehearing en banc, the Fifth Circuit Court of Appeals reversed the dismissal of one of Cochran's claims. The SEC then appealed to the Supreme Court. In its April 2023 decision addressing the consolidated cases, the Supreme Court held that the statutory review schemes set out in the Securities Exchange Act do not displace a district court's federal question jurisdiction over Cochran's constitutional claims. Further, the court held Cochran's claim that she was being subjected to unconstitutional agency authority fell outside of the statutory review schemes in the Exchange Act and was unrelated to the expertise of the commission. Thus, the court concluded that district court review of Cochran's claims was appropriate. In the few days after the court decided *Axon*, Christopher Gibson, an investment adviser entrenched in a seven-year battle with the SEC, sued the agency in the U.S. District Court for the Northern District of Georgia, claiming the agency subjected him to two unconstitutional proceedings. Gibson alleged that the in-house process denied him the right to be tried by a jury, that the ALJs are protected by multiple layers of tenure in violation of Article II of the Constitution, and that the agency is unlawfully exercising legislative power given its ability to decide whether a case is heard before an ALJ or a federal district court judge. A few days after the *Gibson* case was filed, Marian Young, a Texas-based investment adviser whose case had been percolating before the SEC for more than six years, filed suit in the Fifth Circuit challenging the constitutionality of the SEC's ALJ process. Her petition asks the court to free her from "SEC purgatory" and compares the SEC's ALJ process to "Hotel California." In many respects, therefore, both Gibson and Young's allegations resemble Michelle Cochran's, though Cochran's constitutional questions were never addressed directly. Answers to those questions may come soon if the Supreme Court accepts review of the Fifth Circuit's May 2022 decision in *SEC v. Jarkesy*. The petitioner in *Jarkesy* also challenged the constitutionality of the SEC's in-house proceedings. The Fifth Circuit vacated an SEC ALJ's decision and held that the removal protections of the SEC ALJ are unconstitutional. The court also held that the in-house SEC adjudication process is unconstitutional because it violates the right to trial by jury and is an unconstitutional delegation of legislative power to the SEC. In March 2023, the SEC filed a petition for a writ of certiorari to the Supreme Court. Justice Thomas' concurring opinion in *Axon* may provide a preview into the court's attitude toward these issues. In his concurrence, he cautions that "Congress vesting administrative agencies with primary authority to adjudicate core private rights with only deferential judicial review on the back end" raises serious constitutional concerns. Justice Thomas postulates that the agency's review model may violate the separation of powers, may violate Article III by compelling the judiciary to defer to administrative agencies regarding matters within the core of the judicial vesting clause, and may violate due process by empowering entities that are not courts of competent jurisdiction to deprive citizens of private rights. This jibes with what has been referred to as "the quiet death of *Chevron* deference." The phrase describes the recent phenomenon where, although the court has repeatedly declined to overrule *Chevron*, it has instead opted to chip away at its scope, or simply ignore it altogether. **Significance and Key Takeaways** The court's *Axon* decision, and its likely future constitutional review of the agency's administrative litigation procedures, could fundamentally alter the nature of SEC enforcement actions — and in a

way that is not agency-friendly. The SEC may be forced to pursue its enforcement actions in district courts, which tend to be unencumbered by the procedural stratagem associated with in-house administrative courts. Individuals and entities facing current or future administrative procedures before the SEC may choose to consider whether *Axon* provides them an avenue to challenge the procedure's constitutionality in their particular case. Parties challenging the constitutionality of the agency's process may request to stay, or pause, the agency proceedings to bring their challenges in federal court. Parties whose administrative proceedings have already been completed may also consider whether to bring a collateral suit in federal court to challenge the process, rather than permitting the staff to force an administrative appeal in-house. If *Axon* stands for anything, it is that respondents "stuck in SEC purgatory" should not assume they are necessarily confined to an existing administrative and statutory process. Other avenues are open to them.

Members of our Securities Litigation and Enforcement Practice have years of experience both within the SEC Enforcement Division and in private practice counseling clients on these issues. For additional information on this topic, or assistance related to SEC enforcement, please contact the authors of this article or another member of [Carlton Fields' Securities Litigation and Enforcement Practice](#).

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