

Securities Experts React To The High Court's SEC Decision

By **Jessica Corso**

Law360 (April 14, 2023, 9:40 PM EDT) -- The U.S. Supreme Court's decision Friday greenlighting a lawsuit challenging the constitutionality of the U.S. Securities and Exchange Commission's in-house proceedings could slow the agency's administrative courts to a "trickle," particularly as it awaits a possible high court ruling in a case that could strike a more direct blow to those courts, securities experts told Law360.

The court unanimously concluded that certified public accountant Michelle Cochran could continue to pursue her constitutional challenges against the agency in federal court, even though she hasn't gone through the traditional appeal process mandated by Congress. The Supreme Court decided the case alongside a similar challenge that Axon Enterprise brought against the Federal Trade Commission over its in-house proceedings.

Law360 asked securities defense attorneys and legal scholars, some of whom formerly worked at the SEC, for their initial reactions to Friday's ruling in SEC v. Cochran, as well as to weigh in on the possible impact it could have on the agency's enforcement division, which oversees SEC litigation.

Several attorneys pointed to the concurrence written by Justice Clarence Thomas as offering potential insight into a case that the Supreme Court **has yet to take up**, SEC v. Jarkesy. The SEC has petitioned the high court to hear that case, which arises from a Fifth Circuit decision that broadly held the agency's use of its in-house court to bring a securities fraud case was unconstitutional.

And Investor Choice Advocates Network president Nick Morgan, whose organization filed a brief in support of Cochran, has promised that ICAN "will be actively seeking cases to bring in federal court, challenging the constitutionality of the SEC's administration process."

Below are some of the comments that Law360 received immediately following the Supreme Court's ruling. The comments have been edited for length and clarity.



Brad Foster

Haynes and Boone LLP

The result was 9-0, but it wasn't exactly unanimous. Justice Thomas wrote a concurring opinion "expressing grave doubts" about the constitutionality of administrative proceedings, going far beyond the limited holding of the majority opinion. Justice [Neil] Gorsuch strongly disagreed with the majority's approach, but concurred in the judgment because he agreed that Cochran and Axon should prevail.

The concurring opinions are evidence of a fundamental disagreement on the court concerning the constitutionality of federal administrative proceedings. If the court grants the petition for certiorari in *Jarkesy*, the resulting decision is far less likely to be unanimous.



Kurt Gottschall

Haynes and Boone LLP

Even before the Cochran decision, SEC enforcement was filing litigated administrative proceedings almost exclusively when the commission had no other jurisdictional alternative, such as seeking suspensions against accountants and attorneys under Rule 102(e).

The Cochran decision likely will keep SEC litigated administrative proceedings at a slow trickle until the Supreme Court rules on the various constitutional challenges. I also expect that, given the green light in Cochran, more respondents will sue the SEC in district court, raising additional constitutional challenges to the SEC's administrative forum.



John Reed Stark

John Reed Stark Consulting

My take is that the SEC staff do not appreciate the confounding and unprecedented backlog of SEC administrative actions and the unreasonable flouting of SEC rules, which nominally commit the SEC to decide appeals promptly. So in that sense, this ruling is probably welcome by SEC trial lawyers.

However, the decision also serves as a salient reminder of the perils and pitfalls of the twilight zones of discovery and trial in SEC administrative proceedings. In fact, this decision and a few others have now shined an excess of unwanted sunlight on what some experts deem a kangaroo court, where the odds are heavily stacked against anyone opting to do battle with the SEC. Hence, the SEC enforcement division is more likely to bring their contested actions in federal court, or else risk having to allocate precious time and resources to a potentially devastating appeals process where the entire structure of the SEC administrative apparatus could be deemed unconstitutional.



Marc J. Fagel

Stanford Law School

I'm not shocked by the outcome, given the court's increasingly skeptical view toward agency authority, though I'm a little surprised to see a 9-0 decision on anything these days.

The court didn't reach the merits of the SEC's administrative authority, so that will remain at play for years to come. As a practical matter, the SEC has already largely forgone administrative proceedings in litigated cases in recent years, and this decision won't change that posture. Over the long haul, curtailing or eliminating administrative proceedings is a mixed bag; there are fairness concerns regarding the SEC's reliance on such proceedings in many cases, but relegating mundane regulatory matters to jury trials in federal court is hugely inefficient and counterproductive.



Jeffrey Steinfeld

Winston & Strawn LLP

In terms of impact, the court was clear that it was not addressing the underlying constitutional challenges, but only the availability of immediate district court review. That said, the court's opinion gives defendants a clear and immediate way to challenge administrative action and agency authority, which may prompt the agencies to bring their initial actions in the district court, rather than in-house.

Perhaps most interesting, Justice Thomas' concurrence raises "grave doubts" about "the constitutional propriety of Congress vesting administrative agencies with primary authority to adjudicate core private rights with only deferential judicial review on the back end." In essence, Justice Thomas questioned the constitutionality of administrative proceedings to decide cases that involve a monetary penalty, potentially foreshadowing *Jarkesy*.



Christian Schultz

Arnold & Porter

The only thing even remotely surprising about the Supreme Court decision was that the justices were unanimous. The notion that the SEC's administrative law judges were in any way properly positioned to address constitutional questions about their own appointments — and that a defendant in such proceedings would then have to appeal an adverse decision by an ALJ to the SEC and lose again before having the constitutional question heard by a federal appellate court — always seemed contrary to a defendant's due process rights and generally preposterous.



Scott Mascianica

Holland & Knight LLP

The Supreme Court has made clear that the constitutionality of proceedings is a "here-and-now injury" so the ultimate decision to align with the Fifth Circuit on the limits of 78y [the statute that served as the basis for the SEC's argument that Cochran couldn't go to a district court to assert her constitutional challenge] in circumstances like this one is not surprising. The most interesting aspect [is] Justice Thomas' concurrence, which may foreshadow how certain members of the court will lean going forward on other constitutional challenges to administrative proceedings regarding distinctions between public and private rights, as well as Seventh Amendment concerns.



Nick Morgan

ICAN

Back in 2019, when we first filed an amicus brief on behalf of Mark Cuban, Phillip Goldstein and Nelson Obus in support of Michelle Cochran's position in the Fifth Circuit, we thought it was the height of hubris for the SEC to suggest Ms. Cochran could not go to federal court to challenge the constitutionality of the administrative process.

The unfairness of the SEC's process and the enormous amount of resources it takes to resist SEC cases, as illustrated in this matter, inspired us to create ICAN. The court's unanimous decision, authored by Justice Kagan, vindicates our initial reaction to the SEC's hubris.

--Editing by Alanna Weissman and Jay Jackson Jr.