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D.C. Circuit Joins Seventh Circuit in Rejecting Court Challenges to Pending SEC Administrative Enforcement Proceedings

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The U.S. Court of Appeals for the District of Columbia Circuit held today that federal District Courts do not have subject-matter jurisdiction to entertain challenges to ongoing SEC administrative enforcement proceedings. A party to a pending administrative proceeding must defend against that proceeding and then seek review from the SEC Commissioners and, eventually, the federal appellate courts.

The D.C. Circuit's decision in *Jarkesy v. SEC* follows the Seventh Circuit's August 2015 decision in *Bebo v. SEC* in rejecting preemptive constitutional attacks on pending SEC administrative proceedings. In a potentially significant sentence, however, the D.C. Circuit observed that "[t]he result might be different if a constitutional challenge were filed in court *before* the initiation of any administrative proceeding (and the plaintiff could establish standing to bring the judicial action)" (emphasis added). The decision thus flags the potential tension between being too late and being too early to circumvent established procedures for review of SEC proceedings.

Factual Background

The SEC initiated an administrative proceeding against Jarkesy in March 2013. In January 2014, days before the commencement of the hearing before an SEC administrative law judge ("ALJ"), Jarkesy sought injunctive relief in federal District Court to block what he called an unconstitutional administrative proceeding. Although some of Jarkesy's constitutional arguments appear to have been specific to the proceeding against him, others were "facial" constitutional attacks, including that the SEC's use of an administrative proceeding (*i*) deprived Jarkesy of his right to equal protection by denying him a jury trial and by subjecting him to "class of one" treatment (because other litigants have the benefits of federal-court proceedings) and (*ii*) violated the "non-delegation doctrine" and "separation of powers" principles.

The District Court dismissed the case, holding that it lacked subject-matter jurisdiction to entertain the challenge in light of the statutory procedures for review of rulings in administrative proceedings. Under applicable law, a respondent in an SEC administrative proceeding may file a petition for review with the Commission, which can either adopt the ALJ's initial decision as the final decision of the agency or grant the petition and conduct *de novo* review. If the Commission's final decision is adverse, the respondent may seek judicial review under 15 U.S.C. § 78y(a)(1) either in the D.C. Circuit or in the Circuit Court where the respondent resides or has his or her principal place of business.

Jarkesy appealed the dismissal of his suit, and the D.C. Circuit affirmed.

D.C. Circuit's Decision

The D.C. Circuit agreed with the District Court that the statute provides the exclusive route for judicial review of challenges to pending administrative proceedings even where a party to such a proceeding contests the SEC's authority to proceed administratively in the first place. The court concluded that Congressional intent to require litigants to proceed exclusively through the statutory scheme of judicial and administrative review was "fairly discernible in the statutory scheme" and that Jarkesy's claims were "of the type Congress intended to be reviewed within [the] statutory structure."

The court spent little time on the first part of the analysis, because it viewed Congressional intent as relatively clear. The more complicated question was whether Jarkesy's claims were of the type that Congress intended to subject to the statutory structure. To make that assessment, the court applied the three-part test from the Supreme Court's 1994 decision in *Thunder Basin Coal Co. v. Reich*: the presumption of initial administrative review followed by appellate review will be upset if (*i*) preclusion of District Court review "could foreclose all meaningful judicial review," (*ii*) the District Court suit is "wholly collateral to a statute's review provisions," and (*iii*) the claims are "outside the agency's expertise." The Seventh Circuit's *Bebo* decision had considered the first factor to be the "most critical" one, but the D.C. Circuit conducted a "holistic analysis" of all three factors "without assessing whether the capacity for meaningful review would alone suffice to negate [District Court] jurisdiction."

No Foreclosure of Meaningful Judicial Review. The D.C. Circuit held that Jarkesy would not be deprived of meaningful judicial review if he were required to present his constitutional claims first to the ALJ and the Commission and then to the applicable appellate court. The possibility that the ALJ and the Commission might not be able to rule on facial constitutional attacks to the authorizing statute is not determinative: as long as those claims "can eventually reach an Article III court fully competent to adjudicate them, it is of no dispositive significance whether the Commission has the authority to rule on them in the first instance during the agency proceedings."

In so ruling, the D.C. Circuit distinguished Jarkesy's situation from that of the challengers in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, in which the Supreme Court held that subject-matter jurisdiction existed to adjudicate a facial challenge to the statute creating the Public Company Accounting Oversight Board (the "PCAOB"). In *Free Enterprise*, the PCAOB had simply begun an investigation of the petitioners; no proceedings were in progress. Jarkesy, in contrast, did not sue until *after* the administrative proceeding against him had begun, so he "would not have [had] to erect a Trojan-horse challenge to an SEC rule or 'bet the farm' by subjecting himself to unnecessary sanction under the securities laws."

Not Wholly Collateral to Statute's Review Provisions. The court concluded that Jarkesy's claims were "inextricably intertwined with the conduct of the very enforcement proceeding the statute grants the SEC the power to institute and resolve as an initial matter." According to the court, Jarkesy's claims were the "vehicle by which Jarkesy seeks to prevail in his administrative proceeding," and he had raised the same claims as affirmative defenses before the ALJ. The court also rejected "the idea that one could divine an exception to an otherwise exclusive administrative scheme based on the distinction between various types of constitutional challenges" such as facial versus as-applied attacks.

Not Outside Agency's Expertise. As for the third factor – whether the plaintiff's claims were "outside the agency's expertise" – the D.C. Circuit observed that the Supreme Court's post-*Free Enterprise* decision in *Elgin v. Department of Treasury* had clarified that "an agency's relative level of insight into the *merits* of a constitutional question is not determinative." The court noted that a narrow focus on whether the Commission has expertise in constitutional issues "overlooks the Commission's development of concurrent familiarity in issues that regularly arise in the course of its proceedings." The court therefore saw "no reason to conclude that Congress intended to exempt Jarkesy's non-delegation challenge, or any of his other constitutional defenses, from the administrative scheme."

***Jarkesy*'s Implications**

Challenges to SEC administrative proceedings continue to be a hot topic. Those challenges involve at least two sets of issues: the existence of subject-matter jurisdiction to bring the challenge, and the viability of the challenger's substantive constitutional claims. The D.C. Circuit addressed only the jurisdictional issue in *Jarkesy*.

Like the *Bebo* decision, *Jarkesy* was written narrowly and can be limited to its facts. The ruling technically applies only to District Court challenges brought *after* administrative proceedings have commenced. Future litigants might try to distinguish the case in situations involving District Court proceedings filed *before* administrative proceedings have been initiated – although, as the D.C. Circuit observed, such suits could be met with standing and ripeness arguments. Whether some "just right" middle ground exists between too late (and therefore precluded) and too early (and therefore not ripe) remains to be seen.

Jarkesy might also have involved a narrower set of "facial" constitutional attacks than have a number of other cases proceeding through the judicial system. Jarkesy does not appear to have clearly raised attacks based on the Appointments Clause (whether ALJs can constitutionally be appointed by anyone other than the President or the SEC Commissioners) or, perhaps, the separation-of-powers doctrine (whether ALJs are unconstitutionally protected from removal by the President). The D.C. Circuit simply assumed for the sake of argument that Jarkesy had adequately presented a "non-delegation" challenge. Nor does Jarkesy appear to have argued that the SEC's procedural rules for administrative proceedings violate the Due Process Clause. (The SEC last week proposed new rules in an effort to address some of those issues.) In addition, several of Jarkesy's constitutional arguments appear to have focused on the facts of his particular proceeding. Nevertheless, the D.C. Circuit's apparent refusal to distinguish among different types of constitutional arguments might undermine efforts to cabin *Jarkesy* based on which constitutional issues were and were not presented in that case.

Additional appeals involving challenges to SEC administrative proceedings are pending in the Second and Eleventh Circuits. Those courts will likely need to address *Jarkesy*'s and *Bebo*'s jurisdictional rulings in addition to any merits issues presented.