No. 22-859

In The

Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION,

Petitioner,

v.

GEORGE R. JARKESY, JR. and PATRIOT28 LLC,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF ATLANTIC LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF THE *AMICUS CURIAE* [1]

Established in 1977, the Atlantic Legal Foundation (ALF) is a national, nonprofit, nonpartisan, public interest law firm whose mission is to advance the rule of law and civil justice by advocating for individual liberty, free enterprise, property rights, limited and responsible government, sound science in judicial and regulatory proceedings, and effective education, including parental rights and school choice. With the benefit of guidance from the distinguished legal scholars, corporate legal officers, private practitioners, business executives, and prominent scientists who serve on its Board of Directors and Advisory Council, the Foundation pursues its mission by participating as *amicus curiae* in carefully selected appeals before the Supreme Court, federal courts of appeals, and state supreme courts. *See* atlanticlegal.org.

* * *

The overarching issue in this case—whether Securities and Exchange Commission (SEC) "in house" enforcement proceedings are constitutional—is vitally important to every corporation and individual that may become trapped in the SEC's prosecutorial crosshairs. More broadly, the questions presented implicate the power and autonomy of the federal administrative state—the *de facto* "fourth branch" of government.

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[1] No counsel for a party authored this brief in whole or part, and no party or counsel other than the *amicus curiae* and its counsel made a monetary contribution intended to fund preparation or submission of this brief.

As a steadfast advocate for limited and responsible government, civil justice, and due process of law, ALF urges the Court to hold that SEC civil administrative enforcement proceedings are unconstitutional for the reasons discussed in the Fifth Circuit majority opinion. App. 1a-35a. This brief provides additional context to those structural flaws by highlighting some of the significant due process deficiencies that sharply skew enforcement proceedings in the SEC's favor whenever it elects to proceed in-house rather than in district court.

SUMMARY OF ARGUMENT

The SEC is the most aggressive independent regulatory agency in the federal government. *See, e.g.*, Gurbir S. Grewal, Dir., Div. of Enf't, Remarks at Securities Enforcement Forum West 2022 (May 12, 2022) ("[S]ince day one, I've been asking staff to look for ways in which to push the pace of our investigations.");[2] Chris Prentice, *Wall Street enforcement to get tougher as SEC's new top cop gets to work*, Reuters, July 26, 2021 ("Grewal joins an SEC already ramping up enforcement.").[3] According to the SEC's most recent year-end press release, the agency

> filed 760 total enforcement actions in fiscal year 2022, a 9 percent increase over the prior year. These included 462 new, or "stand alone," enforcement actions, a 6.5 percent increase over fiscal year 2021

[2] Available at https://tinyurl.com/3tfknrab.

[3] Available at https://tinyurl.com/mr3hfrxk.

> . . . . The SEC's stand-alone enforcement actions in fiscal year 2022 ran the gamut of conduct, from "first-of-their-kind" actions to cases charging traditional securities law violations.

SEC, Div. of Enf't, Press Release, *SEC Announces Enforcement Results for FY 22* (2022-206) (Nov. 15, 2022).[4]

For reasons known only to the SEC, it chose to file half of these new stand-alone civil enforcement actions administratively, in its own in-house court, rather than in district court. *See* SEC, Addendum to Enf't Div. Press Release, Fiscal Year 2022 (Enforcement Summary Chart).[5] The Fifth Circuit held here (i) that such SEC administrative enforcement proceedings deprive respondents of their Seventh Amendment right to a jury trial, (ii) that Congress unconstitutionally delegated legislative power by failing to provide the SEC with an intelligible principle by which to decide whether to proceed administratively rather than in district court, and (iii) that the statutory for-cause-only removal protection afforded to SEC administrative law judges (ALJs) is unconstitutional. *See* App. 2a, 34a.

These constitutional defects are significantly exacerbated by the patently deficient procedural due process available to corporations and/or individuals when the SEC hales them into an administrative

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[4] Available at https://tinyurl.com/4zb5kzpv.

[5] Available at https://tinyurl.com/ynvn959h.

enforcement proceeding conducted in-house by an SEC-employed ALJ, prosecuted by SEC enforcement staff, and if appealed, reviewed and finalized—virtually always in the SEC's favor—by the Commission.[6] As is the case here, Congress has vested the SEC with absolute (and unconstitutional) authority to deny civil enforcement targets the due process protections that they would receive in a federal district court, such as those embodied in the Federal Rules of Civil Procedure and the Federal Rules of Evidence.

The SEC's Rules of Practice, 17 C.F.R. § 201.100 *et seq.*, are slanted in the agency's favor, both on their face and as applied by the Commission and its ALJs. Under these procedures, the Commission, following *ex parte* interaction with the SEC's investigatory and enforcement staff, decides which corporations and individuals should be civil enforcement targets, and whether to proceed against them in-house rather than in district court. When the Commission decides to prosecute a civil enforcement action in-house, it then also acts as judge.

After an administrative proceeding is initiated, the SEC's rules afford enforcement respondents (i.e., defendants) an unreasonably short period of time to prepare and present a defense at an SEC ALJ-conducted evidentiary hearing. The rules also curtail discovery, ignore the Federal Rules of Evidence

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[6] In this brief the term "Commission" refers to the five appointed SEC Commissioners, as distinct from the federal regulatory agency that the Commissioners head.

(including as to admission of hearsay and expert testimony), and even relegate a respondent's due process right to cross-examine SEC witnesses to the discretion of the ALJ or the Commission. If following a hearing a respondent internally appeals an ALJ's adverse decision, the Commission can place the appeal on the back burner for as long as it chooses, thereby prolonging the financial and reputational harms being inflicted on the respondent by the pendency of the proceeding, and delaying true, albeit highly deferential, judicial review.

All of this deprivation of procedural process supports and underscores the Fifth Circuit's conclusion that as currently structured, SEC civil administrative enforcement proceedings are unconstitutional.

ARGUMENT

Significant Disparities Between SEC In-House Adjudications and District Court Proceedings Exacerbate the Constitutional Defects Identified By the Fifth Circuit

A. The harsh penalties imposed on SEC civil enforcement targets heighten the need for procedural due process

"Procedural due process imposes constraints on governmental decisions which deprive individuals of 'liberty' or 'property' interests within the meaning of the Due Process Clause of the Fifth or Fourteenth Amendment." *Mathews v. Eldridge*, 424 U.S. 319, 332 (1976); *see also Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 541 (1985) ("[T]he Due Process Clause

provides that certain substantive rights — life, liberty, and property — cannot be deprived except pursuant to constitutionally adequate procedures.").

The constitutional guarantee of procedural due process is not limited to Article III judicial proceedings. It also applies to Executive Branch administrative adjudications, such as those conducted by the SEC. From an historical perspective

> due process guarantees were not just standards for the courts, but more prominently were barriers to adjudication outside courts. . . . Such adjudication was an old, recurring threat, and guarantees of due process and other procedural rights would have been meaningless if the government could have avoided them by simply sidestepping the courts.

Philip Hamburger, *The Administrative Evasion of Procedural Rights*, 11 N.Y.U. J.L. & Liberty 915, 940 (2018).

Where, as here, the structural constitutionality of in-house adjudications conducted by a federal regulatory agency is at issue, "[t]he extent to which procedural due process must be afforded the recipient is influenced by the extent to which he may be condemned to suffer grievous loss and depends upon whether the recipient's interest in avoiding that loss outweighs the governmental interest in summary adjudication." *Goldberg v. Kelly*, 397 U.S. 254, 262-63 (1970) (internal quotation marks and citation omitted). The Court in *Mathews v. Eldridge*, 424 U.S.

at 335, set forth "the traditional test for procedural adequacy in the due process context." *Dep't of Homeland Sec. v. Thuraissigiam*, 140 S. Ct. 1959, 2010 (2020).

> *Mathews* dictates that the process due in any given instance is determined by weighing "the private interest that will be affected by the official action" against the Government's asserted interest, "including the function involved" and the burdens the Government would face in providing greater process.

Hamdi v. Rumsfeld, 542 U.S. 507, 529 (2004) (quoting *Mathews*, 424 U.S. at 335).

All SEC civil enforcement targets should be afforded the same high degree of procedural due process, regardless of whether the SEC proceeds in-house rather than in district court. Corporate and individual respondents subjected to SEC administrative enforcement proceedings are threatened by, and actually suffer in the vast majority of adjudicated or settled cases, the same types of grievous financial and other losses as defendants in SEC district court actions. Impairment of SEC enforcement targets' private interests not only include imposition of substantial civil penalties and disgorgement of alleged ill-gotten gains, but also reputational harm and prohibitions against continued participation in the securities industry. *See* Pet. Br. at 3 (citing parallel statutory provisions relating to remedies available in SEC administrative proceedings and in district courts); *see, e.g.*, SEC Press Release,

SEC Charges Hedge Fund Manager and Brokerage CEO with Fraud (Mar. 22, 2013).[7]

SEC's Division of Enforcement year-end press release boasts that during the 2022 fiscal year,

> [m]oney ordered in SEC actions, comprising civil penalties, disgorgement, and pre-judgment interest, totaled $6.439 billion, the most on record in SEC history and up from $3.852 billion in fiscal year 2021. Of the total money ordered, civil penalties, at $4.194 billion, were also the highest on record.

SEC Press Release, *supra.* SEC's statistics combine, rather than distinguish between, these astronomical in-house and district court civil penalties and disgorgements. *See* Addendum to Enf't Div. Press Release, *supra* (Total Money Ordered).

Here, the SEC ordered Respondents "to pay a civil penalty of $ 300,000," ordered Respondent Patriot28 "to disgorge nearly $ 685,000 in ill-gotten gains," and "also barred [Respondent] Jarkesy from various security industry activities." App. 3a. There is no reason why these Respondents should have been deprived of the due process protections that they would have received in federal district court if the SEC had chosen to proceed there rather than before its own ALJs.

The SEC invokes "enforcement discretion" to justify its choosing to proceed administratively rather

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[7] Available at https://www.sec.gov/news/press-release/2022-206.

than judicially. *See* Pet. Br. at 34. But the SEC nowhere asserts that proceeding against enforcement targets in district courts would entail additional "fiscal and administrative burdens," *Mathews*, 424 U.S. at 335, that outweigh "procedures that are necessary to ensure that a citizen is not 'deprived of life, liberty, or property, without due process of law.'" *Hamdi*, 542 U.S. at 529 (2004) (quoting U.S. Const. amend. V).

Indeed, of the 462 new ("stand-alone") civil enforcement actions that SEC filed during FY 2022, half were in district courts. *See* Addendum to SEC Press Release, *supra* (Enforcement Summary Chart). These district court actions involved more than twice as many party defendants as the number of party respondents in the newly filed administrative proceedings. *Id.* Further, according to Respondents, "the cases [the SEC] has diverted to its in-house courts has plummeted, as the constitutional challenges have continued to mount." Br. In Opp. at 4 n.4. The SEC's substantial, increasing, and successful use of district courts to pursue civil enforcement actions belies any contention that proceeding judicially—where defendants are afforded a full panoply of due process protections—is too much of a fiscal or administrative burden for the SEC.

B. SEC in-house adjudications provide civil enforcement targets significantly less procedural due process than district court proceedings

"Congress has given [the SEC] exclusive authority and absolute discretion to decide whether to bring securities fraud enforcement actions within the

agency instead of in an Article III court." App. 28a; *see* 15 U.S.C. § 78u-2(a). This "unfettered discretion . . . effectively gave the SEC the power to decide which defendants should receive *certain legal processes* (those accompanying Article III proceedings) and which should not." App. 26a-27a. Coupled with "relaxed rules of evidence and of procedure," SEC in-house adjudications are "an invitation to bias and a guaranteed appearance of bias." Douglas H. Ginsburg & Steven Menashi, *Our Illiberal Administrative Law*, 10 N.Y.U. J.L. & Liberty 475, 509, 510 (2016). When the SEC "pursues a case in-house, rather than in the courts, the defendant does not get a jury, a real judge, or the real due process of law." Hamburger, *supra* at 917. These procedural rights "are the primary constraint on how the government proceeds against Americans in particular instances - forming a crucial barrier to government misconduct. Nonetheless, administrative adjudication largely evades such rights." *Id.*

As the Fifth Circuit majority opinion observes, SEC "administrative proceedings differ significantly from cases resolved in federal district courts and reviewed by federal courts of appeals." App. 33a n.29.

- Unlike district court judges, the SEC "acts as both prosecutor and judge" when it elects to conduct an in-house enforcement proceeding. *Id.* at 1a. Following internal investigations and *ex parte* communications with enforcement staff, the SEC Commissioners decide whether to authorize the filing of an enforcement proceeding. *See* 17 C.F.R. § 201.200 (Initiation of Proceedings); SEC, Div. of Enf't,

Enforcement Manual (Nov. 2017) § 2.5.1 ("The filing or institution of any enforcement action must be authorized by the Commission.").[8]

In theory, after the Commission authorizes initiation of an administrative enforcement proceeding, SEC investigative and prosecutorial staff, "may not, in that proceeding or one that is factually related, participate or advise in the decision, or in Commission review of the decision." 17 C.F.R. § 201.121. But in attempting to maintain this internal separation of functions, the SEC has been plagued by what it euphemistically calls a "control deficiency"—improper file sharing between SEC adjudicatory and enforcement staff. *See* Margaret A. Little, *The SEC's Bleak House of Cards: Some Reflections on Jarkesy v. SEC and Judicial Doctrine*, 27 Tex. Rev. L. & Pol. 565, 598 (2023).

- "An ALJ assigned to hear an SEC . . . enforcement action has authority, much like a regular trial judge, to resolve motions, hold a hearing, and then issue a decision." *Axon Ent., Inc. v. FTC*, 143 S. Ct. 890, 897-98 (2023). But unlike a district court judge's final judgment, an SEC ALJ's "initial decision" is subject to internal review by the Commission. *See* 17 C.F.R. §§ 201.410, 201.411. "Upon completion of internal review, the Commission enters a final decision," *Axon*, 143 S. Ct. at 898, which then can be appealed to a court of appeals. *See* 15 U.S.C. § 78y(a). "Suffice it to say, even if ALJs have some of the same

[8] Available at https://tinyurl.com/ycxxeusx.

'tools of federal trial judges,' they use those tools at the direction of and with the power delegated to them by the Commission." App. 33a n.29 (quoting *SEC v. Lucia*, 138 S. Ct. 2044, 2053 (2018)).

As Judges Ginsburg and Menashi explained in their article,

> [a]n ALJ's decision is really a recommendation to the agency's political leadership . . . . This structure allows for systematic political bias . . . .
>
> When the agency reviews and perhaps overrules the ALJ in a case the agency heads themselves authorized, the agency is *both a party and the judge in its own case* — an arrangement *at odds with the most basic notion of due process* that a party not be the judge in his own cause.

Ginsburg & Menashi, *supra* at 509-10 (emphasis added).

Along the same lines, Professor Hamburger observed that agency heads such as the SEC Commissioners

> are political appointees who do not hear the witnesses or arguments in the cases, who do not need to read the record, and who often made the decision to prosecute or who at least adopted the underlying prosecutorial policies. In other words, these agency leaders - the ultimate

> decisionmakers in their agencies - usually lack even the pretense of independence.

Hamburger, *supra* at 950.

When a final Commission order following an in-house hearing is appealed to a federal court of appeals, "[t]he findings of the Commission as to the facts, if supported by substantial evidence, are conclusive." 15 U.S.C. § 78y(a)(4). This is a "highly deferential standard of review." *Axon Ent.*, 143 S. Ct. at 907 (Thomas, J., concurring). "Thus, even in court, defendants do not get the decision of a jury or even the independent judgment of a judge on the facts." Hamburger, *supra* at 958; *see Axon Ent.*, 143 S. Ct. at 906 (Thomas, J., concurring) (expressing "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").[9] Instead, "the agency should have to make its case not merely by producing 'substantial evidence' but rather by a preponderance of the evidence, as it would in court, and the agency should not be the body to review the ALJ's decision." Ginsburg & Menashi, *supra* at 511.

- In contrast to the Federal Rules of Civil Procedure and Federal Rules of Evidence prescribed

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[9] On October 6, 2023, the Federal Trade Commission, in light of this Court's jurisdictional decision in *Axon Enterprise*, issued an order dismissing its administrative complaint in order to avoid that company's ongoing structural constitutional challenges to FTC in-house adjudications. *See* FTC, Order Returning Matter To Adjudication and Dismissing Complaint Dkt. No. 9389, available at https://tinyurl.com/2f9far49.

by this Court in accordance with 28 U.S.C. § 2072(a), the SEC has published its own procedural and evidentiary rules. *See* 17 C.F.R. § 201.100 *et seq.* (Rules of Practice). Both on their face and in practice, these rules governing SEC administrative adjudications give the agency a "home court advantage" by tilting the playing field steeply in its favor:

Timing. Although SEC enforcement staff can take months or years to prepare a case, once the Commission initiates an in-house enforcement proceeding through issuance of "an order instituting proceedings," *see* 17 C.F.R. § 201.200, the rules impose tight deadlines for commencing a hearing, and for issuance of the ALJ's initial decision. "In the Commission's discretion," its order instituting proceedings "will specify a time period in which the [ALJ's] initial decision must be filed . . . this time period will be either 30, 60, or 120 days" from "completion of post-hearing briefing in a proceeding where the hearing has been completed." *Id.* § 201.360(a)(2)(i). Depending on which of these time frames the Commission selects, the ALJ generally must schedule the evidentiary hearing to begin within a mere 1 to 4 months. *Id.* § 201.360(a)(2)(ii).

These accelerated time frames severely prejudice the relatively few enforcement targets that have the resources and fortitude to attempt to develop and present a defense within the short time allotted. Such companies and/or individuals have the courage to endure an in-house adjudicatory hearing that is stacked against them, rather than accede to an SEC-

dictated consent order that includes, in addition to financial and other penalties, the SEC's notorious, lifetime, "gag" provision, which violates the First Amendment. *See id.* § 202.5(e) (codifying SEC's policy of prohibiting a respondent or defendant from "denying the allegations in the complaint" or from "creating . . . an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur"); *see also* Amicus Brief of Constitutional Law and First Amendment Scholars, *Romeril v. SEC*, No. 21-1284 (Apr. 2022).

Despite the SEC's rush to judgment at the ALJ level, there is no deadline for how long the Commission can take to review an enforcement respondent's appeal of an ALJ's initial decision. *See* 17 C.F.R. § 201.411. By refraining from issuance of a final order, the Commission can delay for as long as it chooses, the respondent's statutory right to judicial review. *See* 15 U.S.C. § 78y(a) (authorizing court of appeals review of "a final Order of the Commission").

In the case of Respondent Jarkesy, after the ALJ issued an initial decision, "[t]he Commission granted an internal appeal that consumed nearly five years of deliberation before it resulted in a final order." Little, *supra* at 573. Throughout this interminable period of being denied Article III judicial review, Mr. Jarkesy continued to suffer financial and reputational harm. *Id.*

Discovery. SEC's hearing rules also curtail an administrative enforcement respondent's opportunity to conduct discovery. For example, depending on the number of respondents, only 3 to 5 oral depositions

can be conducted. *See* 17 C.F.R. §§ 201.233(a)(1) & (2). If a "compelling need" can be demonstrated, the ALJ merely can allow 1 or 2 additional depositions. *Id.* § 201.233(a)(3).

Evidence. SEC has decided that the Federal Rules of Evidence should not apply in its in-house court. Instead, the broad standard for admissibility of evidence in SEC administrative enforcement proceedings is incredibly lax. *See id.* § 201.320(a). For example, unlike the carefully considered, limited circumstances under which hearsay testimony is allowed in federal district courts, *see* Fed. R. Evid. 801-807, SEC's rules give ALJs wide latitude to admit hearsay. *See* 17 C.F.R. § 201.320(b). Equally if not more important, despite the technical nature of many SEC enforcement proceedings, there is nothing in the SEC's rules comparable to Fed. R. Evid. 702, which as a matter of due process, establishes standards for admission of testimony by expert witnesses. Instead, an SEC ALJ can take official notice of "any matter which is peculiarly within the knowledge of the Commission as an expert body." 17 C.F.R. § 201.323. As a practical matter, when an ALJ takes such official notice, "the applicable burdens of proof and persuasion . . . are often reversed," placing them on the respondent rather than on the SEC. Hamburger, *supra* at 952.

Cross-Examination. This Court has "frequently emphasized that the right to confront and cross-examine witnesses is a fundamental aspect of procedural due process." *Jenkins v. McKeithen*, 395 U.S. 411, 428 (1969). The SEC's administrative

hearing rules, however, unlike Fed. R. Evid. 611(b), do not merely limit the scope of cross-examination to an opposing witness's direct examination or credibility. Instead, in an SEC ALJ proceeding, an enforcement respondent's ability to exercise his right to conduct cross-examination of witnesses is left to "the discretion of the Commission or the [ALJ]." 17 C.F.R. § 201.326. In other words, the SEC decides how much due process an administrative enforcement target gets.

Suspension or Modification of Rules. An SEC enforcement target may not even be afforded the meager procedural due process that the SEC's one-sided administrative hearing rules provide. Under 17 C.F.R. § 201.100(c) the Commission "may by order direct, in a particular proceeding, that an alternate procedure shall apply or that compliance with an otherwise applicable rule is unnecessary."

These and other serious due process deficiencies exacerbate Congress's utter failure to provide any intelligible principle to govern the SEC's choice of pursuing a civil enforcement action in-house rather than in district court. *See* App. 21a. They also magnify the constitutional harms suffered by a respondent's deprivation of the right to trial by jury, *id.* at 5a, or at least an administrative hearing that is not conducted by an unaccountable ALJ who is shielded with unconstitutional removal-from-office protection, *id.* at 28a-29a.

CONCLUSION

The Court should affirm the Fifth Circuit's judgment.

Respectfully submitted,

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