

# KIRKLAND & ELLIS

Kirkland Alert

## FTC and SEC Targets May Prospectively Challenge Constitutionality of Agency Administrative Proceedings

18 April 2023

### Key Takeaways

- On April 14, 2023, the U.S. Supreme Court issued its opinion in *Axon Enterprise, Inc. v. Federal Trade Commission and Securities and Exchange Commission v. Cochran*, holding that parties subject to FTC and SEC administrative proceedings may challenge the constitutionality of those proceedings in federal district court before those proceedings conclude.
- This ruling allows defendants in FTC and SEC administrative actions to offensively commence immediate collateral suits regarding the constitutionality of the administrative action and seek to stay the agency proceeding while the collateral challenge is pending.
- For the FTC, the decision likely will have little effect on pre-consummated merger reviews or rule violation matters, as these actions are filed in federal court already. But it is likely to impact certain matters involving consummated mergers, allegedly anticompetitive conduct, and Section 5 consumer protection and unfair competition cases, which are often pursued through administrative actions.
- For the SEC, in the near term, this decision may cause the SEC to bring more contested actions in federal court.
- The unanimous decision reflects a pattern of the Supreme Court reining in administrative agencies. Instead of requiring administrative defendants to bear the burden of litigating an administrative case to finality *before* raising constitutional challenges to the process – an approach that, in many cases, practically eliminated the viability of the challenge – the court now permits those challenges to be raised

*at the outset*, recognizing that having to defend a constitutionally infirm, “illegitimate proceeding” may present a “here-and-now injury.”

- Defendants have recently raised a host of constitutional arguments against the FTC and SEC’s administrative processes, including due process, equal protection and Article II removal protection challenges; this decision emboldens defendants to bring those challenges in federal court right away. As such, the court’s ruling likely will lead to notable decisions analyzing fundamental and consequential challenges to agency proceedings.

## The Decision

Defendants in both *Axon* and *Cochran* sought to bring immediate challenges to the constitutionality of a “fundamental aspect of the Commission’s structure,” which allegedly renders the entirety of the administrative proceedings they faced unlawful.

The FTC and the SEC have similar administrative enforcement processes: The Commission may, instead of filing suit in federal court, delegate an initial adjudication to an administrative law judge (ALJ), who is removable “only for good cause,” including “neglect of duty” or “malfeasance,” as the Merit Systems Protection Board (a separate agency whose members are also removable only for good cause) may decide. Appeals of the ALJ decision go to the full Commission for decision; and each Commission may review any ALJ decision at its prerogative. Once the Commission announces a decision, a respondent can appeal to a federal circuit court. In both *Axon* and *Cochran*, the respondents challenged the constitutionality of the ALJ himself, on the basis that the ALJ is unconstitutionally insulated from presidential supervision by “dual-layer protection”: the ALJ can be removed only for good cause by the Merit Systems Protection Board whose members can be removed only for good cause by the president. *Axon* also challenged the constitutionality of combining prosecutorial and adjudicative functions within the Commission.

Justice Kagan delivered the majority opinion, joined by all justices except Gorsuch, who filed a separate concurring opinion.<sup>1</sup> The court noted that the underlying challenges to the FTC and SEC’s administrative enforcement actions were “fundamental, even existential.” The question answered by the court, however, was far narrower: Who may hear constitutional challenges to the FTC and SEC’s enforcement actions?

The court concluded that neither the relevant FTC nor SEC statutes divest federal district courts of jurisdiction to hear collateral constitutional challenges to administrative proceedings. It explained that the three *Thunder Basin*<sup>2</sup> considerations guide the inquiry into whether district courts retain jurisdiction to hear such challenges:

1. “[C]ould precluding district court jurisdiction foreclose all meaningful judicial review of the claim?”
2. “[I]s the claim wholly collateral to [the] statute’s review provisions?” and
3. “[I]s the claim outside the agency’s expertise?”<sup>3</sup>

The court noted that if the answers to all three questions are “yes,” the presumption is that Congress did *not* intend to limit the broad general jurisdiction of the district courts. Importantly, the court explained that the “same conclusion might follow [even] if the factors point in different directions.”

In the cases at hand, the court found that all three factors point in the same direction – to the continuing existence of district court jurisdiction.

On the first factor of “meaningful judicial review,” the court explained: “A proceeding that has already happened cannot be undone. Judicial review of Axon’s (and Cochran’s) structural constitutional claims would come too late to be meaningful.” In doing so, the court recognized the “here-and-now injury” that the respondents suffered by being subject to proceedings they believed to be unconstitutional.

The court found the “collateralism factor favors Axon and Cochran for much the same reason – the constitutional challenges are collateral to the proceedings because they are challenging the Commissions’ power to proceed at all, rather than actions taken in the agency proceedings.”

Finally, the court noted that issues of constitutionality fall outside the expertise of either the FTC or the SEC. It then held that such claims are not “of the type” the FTC or SEC’s statutory schemes address and, accordingly, are properly reviewable by the district court.

## Implications

Now that the court has held collateral constitutional challenges may go directly to federal district court before administrative proceedings conclude, it is likely that

parties seeking to make such challenges will do so through declaratory judgment actions immediately upon commencement of administrative proceedings, rather than submitting to the Commissions' processes in the first instance. The Supreme Court's emphasis on the "here-and-now" nature of the injury attendant to constitutional challenges also suggests that administrative proceedings may potentially be stayed while constitutional challenges play out in federal court.

This likely will significantly impact FTC administrative proceedings. The Commission almost always wins in its own administrative forum, meaning respondents must endure negative publicity and long delays before potentially securing favorable outcomes through judicial appeals. The FTC is able to leverage these realities during pre-suit settlement negotiations. If companies are able to secure speedy federal court review, however, they have the opportunity to secure a favorable outcome earlier. Moreover, we expect these collateral challenges will invite a host of creative and potentially persuasive constitutional challenges to the administrative process, some of which may prove to be significant challenges for the Commission.

Meanwhile, the SEC's administrative proceedings have been under near constant attack over the past several years. In 2018, the court held in *Lucia v. SEC* that the SEC's ALJs are Article II officers who need to be appointed, not mere employees as had been assumed, because they "hold a continuing office established by law ... to a position created by statute" and "have equivalent duties and powers ... in conducting adversarial inquiries" as other adjudicators that the court has found qualify as principal officers. Before the court even released its opinion in *Lucia*, the SEC ratified the appointment of its ALJs to address any concerns that administrative proceedings presided over by SEC ALJs violate the Appointments Clause of the Constitution. This past June, in *Jarkesy v. SEC*, the U.S. Court of Appeals for the Fifth Circuit held that aspects of the SEC's structure are unconstitutional. Specifically, the Fifth Circuit held that the president lacks constitutionally sufficient control over the work of the SEC's ALJs. For a more detailed discussion of *Lucia* and *Jarkesy*, please see our previous [client Alert](#). In practice, few SEC investigations actually result in litigation; the vast majority of defendants settle, and we expect that to continue to be the case. As a result of the court's decision in *Cochran*, however, we expect that the SEC will carefully consider whether it is advisable to bring certain actions as administrative proceedings and may further limit the types of claims it brings as administrative proceedings, opting instead to file in federal court, which is a lengthier venue. That said, we do not expect any slowdown in terms of the volume of SEC enforcement investigations and actions.

Eventually, we expect that impactful decisions will be made regarding the constitutionality of the FTC's and SEC's administrative proceedings, which will provide clarity regarding appropriate use, if any, of administrative proceedings.

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1. Justice Thomas joined the majority and also issued a concurrence.↩

2. See *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200 (1994).↩

3. Internal citations omitted.↩

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