

[Securities Regulation Daily Wrap Up, TOP STORY—2d. Cir.: Opponents of SEC’s ALJ regime dealt appellate setback, \(Jun. 1, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Amanda Maine, J.D.](#)

A panel of the Second Circuit Court of Appeals rejected arguments from prominent businesswoman Lynn Tilton regarding the ability of respondents in SEC administrative proceedings to force constitutional arguments to be heard in federal district court. The divided panel sided with the lower court’s finding that it did not have subject matter jurisdiction ([Tilton v. SEC](#), June 1, 2016, Sack, R.).

Lower court proceedings. The SEC instituted administrative proceedings against Tilton and several of her Patriarch Partners investment firms alleging fraud under the Investment Advisers Act. Tilton brought suit in the Southern District of New York seeking to enjoin the administrative proceedings, asserting that the appointment of the SEC’s administrative law judge violated the U.S. Constitution’s Appropriations Clause. The district court dismissed Tilton’s lawsuit, finding that the court lacked subject matter jurisdiction. Tilton appealed.

ALJ controversy. The Tilton case is one of many the federal judiciary has recently encountered implicating the SEC’s administrative proceedings and the constitutionality of its ALJs. Several courts, including circuit courts ([Jarkesy v. SEC](#) (DC Cir.), [Bebo v SEC](#) (7th Cir.)), have sided with the SEC in finding that respondents in SEC administrative proceedings cannot bring their constitutional claims in district court, but must complete the administrative process, which encompasses an initial decision by an ALJ and *de novo* review by the Commission itself, after which they may seek redress in the federal courts. Some district courts, however, have sided with respondents and have stayed the SEC’s administrative proceedings against them.

Thunder Basin factors. A panel of the Second Circuit examined the issue under factors outlined in *Thunder Basin*, *Free Enterprise*, and *Elgin*. Under these decisions, courts should presume that a claim is not confined to administrative channels if 1) a finding of preclusion could foreclose all meaningful judicial review; 2) if the suit is “wholly collateral” to a statute’s review provisions; and 3) if the claims are outside the agency’s expertise. The panel addressed each factor in turn.

Meaningful judicial review. Tilton argued that going through the administrative proceeding and appeals process to address her constitutional claims would deny her “meaningful judicial review” because the “grave constitutional injury” could not be redressed after the fact. She cited the Supreme Court’s [Free Enterprise](#) decision in support, stating that *Free Enterprise* suggests that an Article II challenge to an administrative tribunal is not meaningful if conducted after the tribunal’s proceeding concludes. Judge Sack, writing for the two-judge majority of the appellate panel, disagreed with this reading of *Free Enterprise*, noting that the Supreme Court’s analysis in that case turned on the accessibility of post-proceeding review by a federal court of appeals on unreviewable actions by the Public Company Accounting Oversight Board, and not whether such a review could adequately remedy the alleged constitutional violations.

The panel also pointed out that even litigants in federal court must usually wait to appeal an issue until after the court renders its final judgment. A party forced to seek post-proceeding judicial review may endure substantial expenses and other disruptions, but this hardship, the panel noted, has been deemed “part of the social burden of living under government,” rather than irreparable injury.

Wholly collateral. The panel also agreed with the lower court that Tilton’s claim was not “wholly collateral” to the SEC’s administrative scheme. While it acknowledged that her constitutional claim was substantively unrelated to the securities law violations underlying the proceeding, it noted that it was nevertheless “procedurally intertwined” with the proceeding because the constitutional claims function as an affirmative defense.

Agency expertise. The final *Thunder Basin* factor involves whether Tilton’s Appointments Clause claim falls outside of the SEC’s expertise. Citing the *Elgin* decision, the panel said that, while the SEC may not possess unique legal expertise about the constitutionality of its appointments, it can still bring its expertise on matters that it routinely considers and that might dispose of the case in Tilton’s favor. In particular, the panel stated that the Commission could rule that Tilton and her companies did not violate the charged provisions of the Advisers Act, in which case, the constitutional question would be moot. The Commission, according to the panel, may also use its expertise in a manner relevant to the constitutional issue by resolving the statutory charges against the respondents in the administrative proceeding. For these reasons, a majority of the panel found that the agency expertise factor of *Thunder Basin* gave minimal support to Tilton’s jurisdictional argument.

Concurrence. Judge Newman agreed with the reasoning put forth by Judge Sack, but added in a concurring opinion that the ALJ has “colorable jurisdiction,” meaning that even if its constitutionality is in doubt, an order issued by the ALJ must be obeyed and enforced under threat of criminal contempt.

Dissent. Judge Droney dissented from the decision. Unlike the majority of the panel, he found it indistinguishable from *Free Enterprise*, other than that the administrative proceedings had already been instituted against Tilton and her companies. He also argued that the majority opinion had stripped the “wholly collateral” and “agency expertise” factors of any significance. The available judicial review to Tilton is not meaningful enough to ignore those two factors, he said. He also disagreed with the majority’s application of *Elgin* to the case at hand because a different type of constitutional claim (the substance of the Selective Service Act, rather than the available administrative process) was presented. According to Judge Droney, the decision of the district court should be reversed and remanded for adjudication of Tilton’s Appointments Clause claim.

The case is [No. 15-2103](#).

Attorneys: Susan E. Brune (Brune Law P.C.) for Lynn Tilton, Patriarch Partners, LLC and Patriarch Partners VIII, LLC. Megan Barbero, U.S. Department of Justice, for the SEC.

Companies: Patriarch Partners, LLC; Patriarch Partners VIII, LLC

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