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VIA ECF

The Honorable Ronnie Abrams
United States District Court, Southern District of New York
40 Foley Square, Room 2203
New York, NY 10007

Re: *Tilton et al. v. Securities and Exchange Commission*, No. 16-cv-7048 (RA)

Dear Judge Abrams:

We write as counsel for Plaintiffs Lynn Tilton, Patriarch Partners, LLC, Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (collectively, "Plaintiffs") pursuant to the Court's September 20 Order (Dkt. 8), directing Plaintiffs to explain why this action is not barred by *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016).[1] There, the Second Circuit held that "Congress implicitly precluded federal district court jurisdiction over the appellants' constitutional challenge" to the appointment of the agency's administrative law judges under the Appointments Clause. *Id.* at 279. Because the claims alleged here differ materially from the Appointments Clause challenge addressed by the Second Circuit, *Tilton* is not controlling.

This action presents facial due process and equal protection claims against the Securities and Exchange Commission ("SEC"). It seeks to enjoin the SEC's pattern and practice of violating the due process rights of respondents in administrative civil enforcement proceedings by systematically preventing them from developing a factual record and mounting a meaningful defense (Compl. ¶ 1).[2] Plaintiffs point to, *inter alia*, the SEC's "pattern and practice" of conducting lengthy investigations and delaying formal charges (¶¶ 34-35), while imposing rigid and compressed schedules for administrative hearings and initial decisions regardless of a case's complexity (¶ 36);

[1] Because the Second Circuit's mandate had issued and the original *Tilton* case was no longer pending before this Court when Plaintiffs filed this action, we did not designate it as "related" to the original action. Indeed, we did not believe we could do so pursuant to Rule 13(a)(2)(B) of the S.D.N.Y. Rules for the Division of Business Among District Judges, which directs that "civil cases presumptively shall not be deemed related unless both cases are pending before the Court (or the earlier case is on appeal)." *See also* Mandate, *Tilton v. SEC*, No. 15-cv-2472 (Sept. 2, 2016). While Plaintiffs had filed a stay application with the Supreme Court (an application that was denied earlier today), there was no case pending in any court when Plaintiffs filed their Complaint. Accordingly, Plaintiffs sought to have this case assigned to the Honorable Richard M. Berman as related to *Duka v. SEC*, No. 15-cv-357 (RMB), on the ground that such designation would further efficient resolution of the dispute because *Duka* was still pending on remand to that court, and presented significant overlap – an Appointments Clause challenge identical to Plaintiffs' original action, a similar threshold jurisdictional inquiry, and the same defendant.

[2] All references to paragraph numbers in this letter are to paragraphs in the Complaint. Dkt. 1.

issuing vague charging documents that fail to afford respondents sufficient notice of the charges against them (¶¶ 37-38); using discovery and evidentiary rules to bolster weak cases with unreliable, inadmissible evidence and expert opinions that would not be permitted in federal court (¶¶ 39-41); withholding exculpatory material (¶¶ 42-47); and assuring an uneven evidentiary playing field by conducting their own investigative depositions but denying respondents depositions, even where such discovery would serve the interests of justice (¶¶ 48-55). The Complaint requests declaratory and injunctive relief, including but not limited to enjoining the SEC from continuing such practices and policies in current and future proceedings (¶¶ 122-31).

This action also raises an equal protection challenge to the SEC's refusal to apply its new, broader discovery rules to respondents such as Tilton. In an attempt to ameliorate the inherent unfairness of its administrative hearing procedures, the SEC recently amended several of its rules. *See* Final Rule, *Amendments to the Commission's Rules of Practice*, 81 Fed. Reg. 50,212, 50,214 (July 29, 2016) (to be codified at 17 C.F.R. pt. 201) (¶¶ 81-83). However, the SEC timed the publication of those rules so that they do not apply to certain individuals such as Tilton who challenged the SEC's appointment scheme for ALJs as unconstitutional in federal court. "Wholly apart from [the] due process violations" alleged here (¶ 8), Plaintiffs have brought an equal protection claim seeking to redress the SEC's discriminatory treatment of these individuals, including four similarly situated persons who brought Appointments Clause challenges—Barbara Duka (¶ 73), Charles L. Hill (¶ 74), Laurence O. Gray and Gray Financial Group, Inc. (¶ 76), and Tilton herself (¶ 77)—and who will now be deprived of the benefit of the SEC's Amended Rules, which allow for at least five depositions, greater flexibility in scheduling and preparing for hearings, and other benefits, upon returning to their SEC administrative proceeding.[3]

These claims are distinct from Plaintiffs' Appointments Clause challenge because they are predicated on facts in administrative proceedings involving other respondents and require factual development that cannot be obtained in the context of Plaintiffs' individual administrative enforcement proceeding. Accordingly, the question of whether this Court has jurisdiction to address them at this juncture is not resolved by the Second Circuit's ruling in *Tilton*.

A. *Tilton* Did Not Address Federal Courts' Jurisdiction Over *All* Constitutional Claims Raised During Ongoing Administrative Proceedings.

In dismissing Plaintiffs' prior challenge, the Second Circuit held that the "SEC's scheme precludes district court jurisdiction," *Tilton*, 824 F.3d at 281, only if the claims are "'of the type Congress intended to be reviewed within th[e] [SEC's] statutory structure,'" *id.* (quoting *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 489 (2010)). Because Plaintiffs' due process and equal protection claims are materially different from their prior Appointments Clause challenge, *Tilton*

[3] Although at the time of the filing of the Complaint, *Hill* and *Gray* were still pending before the Eleventh Circuit, the mandate has since issued in those cases, ensuring that the Amended Rules will also not apply to them. *See* Mandate, *Gray Fin. Grp., Inc. v. SEC*, No. 15-13738 (11th Cir. Sept. 14, 2016).

does not preclude the exercise of jurisdiction here.

To the contrary, the Supreme Court has affirmed that jurisdiction lies "over an action alleging a [similar] pattern or practice of procedural due process violations by the Immigration and Naturalization Service" in *McNary v. Haitian Refugee Center, Inc.*, 498 U.S. 479, 483-84 (1991).[4] As in *McNary*, Plaintiffs do not challenge a single "order" of the Commission, but rather a pattern of practices and policies that deprive respondents in administrative enforcement proceedings of a meaningful opportunity to develop their defenses. The SEC's statutory regime does not expressly preclude jurisdiction over Plaintiffs' claims.[5] *See* 15 U.S.C. § 80b-13(a) (Commission "orders" must be appealed to courts of appeals). Nor does it *implicitly* preclude these types of claims from proceeding in federal district court because—as in *McNary*—"respondents would not as a practical matter be able to obtain meaningful judicial review of their . . . objections to [agency] procedures" under the SEC's statutory scheme. 498 U.S. at 496. Instead, administrative and judicial review here would be "confined to the record made in the proceeding at the initial decisionmaking level, and one of the central attacks on [the SEC's] procedures in this litigation is based on the claim that such procedures do not allow applicants to assemble adequate records." *Id.* "To establish the unfairness of the [SEC] practices," Plaintiffs must "adduce[] a substantial amount of evidence, most of which would [be] irrelevant in . . . [an] individual [administrative proceeding]." *Id.* at 497. As a result, "[n]ot only would a court of appeals reviewing an individual [administrative proceeding] . . . most likely not have an adequate record as to the pattern of [the SEC's] allegedly unconstitutional practices, but it also would lack the factfinding and record-developing capabilities of a federal district court" necessary to build such a record. *Id.* Thus, this Court has jurisdiction over Plaintiffs' due process claim.

The same holds true for Plaintiffs' equal protection claim. In the pending administrative proceeding, Plaintiffs sought to subpoena the Commission regarding the timing of the Amended Rules and any discussions between and among the Commission and third parties about Ms. Tilton, the Patriarch entities, the pending proceedings, and the applicability of the Amended Rules. The ALJ largely denied these requests, while acknowledging that they related to "collateral issues to th[e] administrative proceeding" (¶ 98). As a result, there can be no doubt that Plaintiffs will be

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[4] *See also, e.g.*, *Campos v. Nail*, 940 F.2d 495, 498 (9th Cir. 1991) (district court jurisdiction over pattern and practice claim); *Elk Run Coal Co., Inc. v. U.S. Dep't of Labor*, 804 F. Supp. 2d 8, 22 (D.D.C. 2011) (same); *Am. Coal Co. v. Mine Safety and Health Admin.*, No. 08-CV-0814-MJR, 2010 WL 653113, at *6 (S.D. Ill. Feb. 19, 2010) (finding jurisdiction over pattern and practice claim but dismissing for failure to state a claim).

[5] The Ninth Circuit construed *McNary* not to allow jurisdiction over a claim regarding counsel in immigration proceedings, which was based on a statute requiring "all questions of law and fact" to be raised in the administrative proceeding. *See J.E. F.M. et al. v. Lynch*, Nos. 15-35738, 15-35739, 2016 WL 5030344, at *10 (9th Cir. Sept. 20, 2016) (interpreting 8 U.S.C. §§ 1252(a)(5), (b)(9)). The statute here does not include similarly sweeping language, as the circuit held: "The statutes that establish the SEC's scheme of administrative and judicial review, including the Dodd-Frank Act and the Investment Advisers Act, do not expressly preclude federal district court jurisdiction over the appellants' . . . claim. The crucial jurisdictional issue in this case, therefore, is whether the statutes do so implicitly." *Tilton*, 824 F.3d at 281.

unable to obtain the evidence necessary to support a claim of improper motives in the SEC's decision-making process as part of the ongoing administrative proceedings.

As Judge Rakoff recognized in finding jurisdiction over an equal protection claim, "the SEC's administrative machinery does not provide a reasonable mechanism for raising or pursuing" claims alleging that the "SEC intentionally, irrationally, and illegally singled [respondents] out for unequal treatment in a bad faith attempt to deprive [them] of constitutional and other rights." *Gupta v. S.E.C.*, 796 F. Supp. 2d 503, 513 (S.D.N.Y. 2011); *see also id.* at 513-14 ("The SEC's Rules of Practice do not permit counterclaims against the SEC . . . nor . . . allow the kind of discovery of SEC personnel that would be necessary to elicit [corroborative] admissible evidence."). Because such a claim is wholly collateral to the SEC proceedings, "nothing that happens in the administrative proceeding will bear on this claim, and no administrative record bearing on this claim will be developed for any federal appellate court to review." *Id.* at 514. The Second Circuit's decision in *Tilton* did not disturb Judge Rakoff's reasoned analysis in *Gupta*.[6]

B. The Analysis In *Tilton* Supports District Court Jurisdiction In This Case.

In dismissing Plaintiffs' Appointments Clause challenge, the Second Circuit applied the factors set forth in *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200 (1994), concluding that Congress intended for Plaintiffs' claim to be covered by the SEC's statutory review scheme. As explained above and below, each of these factors counsels in favor of finding jurisdiction here.

First, Plaintiffs' prior Appointments Clause challenge involves "purely legal questions" that "are not fact-dependent," distinguishing it from "fact-intensive" claims like those raised here and in *Gupta*. *Tilton v. SEC*, No. 15-cv-2472 (RA), 2015 WL 4006165, at *9 n.8 (S.D.N.Y. June 30, 2015) (acknowledging that "certain avenues of relevant discovery, such as 'discovery of SEC personnel,' would have been precluded in Gupta's administrative proceeding" (citation omitted)). Because Plaintiffs' claims require significant factual development that cannot be achieved in an individual administrative proceeding or on remand under the SEC's rules, the Second Circuit's ruling that Plaintiffs could obtain "meaningful judicial review" of their Appointments Clause claim through "post-proceeding review by a federal court of appeals," *Tilton*, 824 F.3d at 284, is not controlling here.

Second, whereas the Second Circuit held that Plaintiffs' Appointments Clause challenge

[6] The Second Circuit recently scheduled argument in *Chau v. SEC*, No. 14-cv-1903 (LAK), 2014 WL 6984236 (S.D.N.Y. Dec. 11, 2014), which involves an equal protection claim similar to Plaintiffs' and to *Gupta*. Although Judge Kaplan rejected a "class-of-one" equal protection claim in *Chau*, it was significantly narrower than Plaintiffs', which implicates at least four other respondents and is unrelated to the merits of the actions against them. The Second Circuit stayed *Chau* and *Duka* pending disposition of *Tilton*; it vacated *Duka* but scheduled *Chau* for argument. *See* Order Adjoining Case, *Chau v. SEC*, No. 15-461 (2d Cir. Dec. 4, 2015); Case Calendaring for Oral Arg., *Chau v. SEC*, No. 15-461 (2d Cir. Aug. 16, 2016).

was not "wholly collateral" to the administrative proceeding because it raised an "affirmative defense" and "identifi[ed] a purported error in the way the Commission . . . sought to enforce the securities laws," *id.* at 288, Plaintiffs' claims here do not "have the effect of establishing" Plaintiffs' "entitlement" to relief from an adverse order in the administrative proceeding, *McNary*, 498 U.S. at 495. A favorable ruling would not "serve to end administrative proceedings" altogether, *Tilton*, 824 F.3d at 295 (Droney, J., dissenting), but instead would simply require the SEC to apply fair procedures to all pending and future administrative proceedings, including any involving Plaintiffs, *see McNary*, 498 U.S. at 494-95.

Third, Plaintiffs' due process and equal protection claims fall outside the SEC's expertise. A Commission finding in Plaintiffs' favor will not "moot" the SEC's pattern and practice of due process violations. *See Campos*, 940 F.2d at 498 ("only through an action in district court [can] . . . injured class members . . . obtain an injunction stopping the unconstitutional practice"). Nor will it remedy the equal protection violation, as the discriminatory act has already occurred and cannot be undone by dismissal of the administrative proceeding. *See United States v. Armstrong*, 517 U.S. 456, 463 (1996) ("selective-prosecution claim is not a defense . . . to the criminal charge itself, but an independent assertion that the prosecutor has brought the charge for reasons forbidden by the Constitution"). Thus, as in *Free Enterprise*, the claims raised here are "unrelated to any 'statutory' or 'fact-bound inquiries' that the SEC might be singularly qualified to perform." *Tilton*, 824 F.3d at 289 (quotation omitted). Moreover, *Tilton*'s conclusion that the Appointments Clause claim was not "outside the [SEC's] expertise" because "a favorable Commission order . . . would provide an acceptable resolution of the . . . claim and obviate any need for judicial review," *id.* at 290, compels the opposite conclusion here. A favorable Commission order would not, and could not, give Plaintiffs the relief they seek here: an order "enjoining the Commission from [its alleged pattern and practice] in current and future proceedings" (¶ 132(B)), "directing the Commission to issue guidance and provide training to Division staff regarding compliance with their obligations under *Brady*" (¶ 132(C)), and "directing the Commission to apply the Amended Rules of Practice to Plaintiffs and similarly situated individuals" (¶ 132(E)). Such relief is distinct from "prevail[ing]" in any one administrative proceeding. *Tilton*, 824 F.3d at 287.

For the foregoing reasons, we respectfully submit that the Second Circuit's *Tilton* decision does not foreclose jurisdiction here. This issue, along with broader questions about the fairness of the SEC's proceedings, merits full consideration by this Court in the normal course, rather than summary letter briefing and disposition.

Respectfully,

/s/ Randy M. Mastro

Randy M. Mastro

cc: Jean Lin, Justin Sandberg, Christopher Connolly, Talia Kraemer

CERTIFICATE OF SERVICE

I hereby certify that on this 27th day of September, 2016, I caused the foregoing Letter Brief to be filed with the Clerk of Court for the U.S. District Court for the Southern District of New York via the Court's CM/ECF system. I further certify that service was accomplished on the following consenting parties via electronic mail:

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