

## **Securities Regulation Daily Wrap Up, ENFORCEMENT—11th Cir.: Seventh Circuit is focus of reply brief in Hill ALJ case, (Sep. 11, 2015)**

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By Mark S. Nelson, J.D.

Charles L. Hill, Jr. and the SEC are setting the stage for the agency's appeal of its loss in a Georgia federal district court over the constitutionality of its administrative law judges. Hill won a preliminary injunction halting the administrative proceeding against him which he wants the Eleventh Circuit to uphold, while the SEC argues that Article II of the U.S. Constitution is no barrier to its employee ALJs hearing administrative cases, including the insider trading charges the agency brought against Hill (*Hill v. SEC*, September 8, 2015).

**Hill chides Bebo court.** Hill would like to get to the merits of his claims against the SEC, but before that can happen, the appeals court must decide if the trial judge in Hill's federal court challenge to the SEC's ALJ regime properly exercised subject matter jurisdiction. Hill sued the SEC because he believes the agency's ALJs are inferior officers subject to the appointments clause.

According to Hill, the SEC has it wrong that his matter is the type Congress wanted to subject to the agency's administrative machinery. Hill points first to the similarities between his claims and the "systemic" ones persons challenging the constitutionality of the PCAOB brought in the Supreme Court's *Free Enterprise* opinion.

Among other things, the court in *Free Enterprise* said there would be no meaningful judicial review unless the challengers could go forward with their case, and the court declined to force the challengers to "bet the farm" by deliberately incurring a sanction just to get the attention of the federal courts.

Moreover, Hill takes aim at the recent Seventh Circuit's decision affirming a district courts' refusal to exercise subject matter jurisdiction over Laurie A. Bebo's suit disputing the legality of the SEC's ALJs. Hill said the *Bebo* opinion misread *Free Enterprise* as being narrowly limited to its specific facts. Hill also argues that a future decision by the Eleventh Circuit that would follow the Seventh Circuit could enhance *Bebo*'s tendency to spur new pre-enforcement suits which the SEC may side-step by asserting ripeness issues.

Later, Hill would explain that only outsiders to agency matters could bring claims like his if the Eleventh Circuit follows *Bebo*. "If *Free Enterprise*'s holding is as narrow as the SEC and the *Bebo* panel believe, it produces an ironic result. Under that view, the only litigant who could challenge the constitutionality of the SEC's in-house proceeding is someone who is outside of it."

Hill also noted that a savings clause in a law can help buoy the case for district court jurisdiction. Hill's lawyers point to Exchange Act Section 28(a)(2), which provides in a rule of construction that, other than items listed in another subsection, the rights and remedies in the Exchange Act are in addition to all other legal or equitable rights and remedies that may be available. Hill suggested that the Supreme Court in *Thunder Basin*, one of several cases in a string of cases that includes *Free Enterprise*, distinguished cases where a savings clause exists (e.g., *Gardner*) from decisions in which the court found no jurisdiction to hear claims about federal agencies.

The SEC has a different take on the jurisdictional question. The agency's brief in *Hill* noted that the ALJ in Hill's matter rejected the Article II claim after initially doubting his authority. According to the SEC, the district court judge erred both by enjoining an ongoing administrative proceeding and by finding prematurely that Hill would likely win his claim that the SEC's ALJs are inferior officers under Article II.

**Raymond J. Lucia Companies.** The SEC and Hill disagreed on yet another key aspect of the jurisdictional issue—what to do about the three factors the Supreme Court has said may salvage district court jurisdiction in some cases. Hill says he will be deprived of all meaningful judicial review if he is forced to go through an unconstitutional agency process and that his constitutional claims do not imply the SEC's technical expertise, the primary justification for shunting enforcement cases into the ALJ regime in the first place.

Hill argued that the Commission's opinion in *Raymond J. Lucia Companies*, issued just ahead of Labor Day weekend, is inapt because it demonstrates the futility of Hill making his constitutional claims in an administrative proceeding. The Commission in that matter upheld part of an ALJ's decision involving Investment Adviser Act claims, while reversing part of the ALJ's decision, and then going on to decide that its ALJs are employees, not inferior officers.

The SEC's brief in the *Hill* case only briefly mentioned an earlier order in the *Raymond J. Lucia Companies* matter in a footnote. But it is possible the SEC will offer a supplemental filing to the Eleventh Circuit with more details about the matter because the agency filed its brief in *Hill* a month before the Commission issued its opinion in *Raymond J. Lucia Companies*. The SEC may argue that this opinion demonstrates the breadth of the agency's expertise on an issue that a federal appeals court can later review under the procedure set out by the Exchange Act.

Yet another aspect of *Raymond J. Lucia Companies* matter is the Commission's lack of unanimity. The two dissenting commissioners have not yet publicly issued their separate opinion. As a result, it remains to be seen specifically which aspects of the Commission's opinion the dissenters highlighted.

Moreover, the SEC's *Hill* brief argued that all legal questions arising in an agency enforcement proceeding must be channeled through the SEC before getting heard by a federal appeals court. Hill disputes this assertion by arguing instead that his constitutional claims are wholly collateral to the "substantive merits" of the SEC's administrative proceeding against him.

Hill did not mention the two approaches noted by the Seventh Circuit in *Bebo* under which a court may either focus on the relationship between the merits of the constitutional claim and the facts in the agency matter or whether the constitutional claims are just a way to dispute the agency action. The Seventh Circuit suggested the district court in *Hill* took the first route. The SEC's *Hill* brief was filed before the Seventh Circuit decided *Bebo*, so the agency may have more to say on this point in a later filing with the Eleventh Circuit.

And to the extent Hill's claims can be viewed as facial or as-applied ones, Hill and the SEC are likely to find little common ground. As Hill's brief notes, the Supreme Court in *Elgin* observed that the line between facial and as-applied challenges can be fuzzy. By contrast, the SEC notes that *Elgin* rejected both types of claims and instead urged the Eleventh Circuit to lean on its 2015 *LabMD* decision in which it said that all constitutional claims had be channeled through the agency process.

**The merits.** When the case gets to the merits question of whether the SEC's ALJs are inferior officers or employees, both Hill and the SEC appear ready to rely on the old standby citations. The Eleventh Circuit issued an order partially granting the SEC's request to expedite the appeal for merits consideration once the briefing stage ends.

Hill argues that the Supreme Court's *Freytag* opinion applies because the SEC's ALJs exercise discretion akin to powers held by the Tax Court's special trial judges, whom the high court said were inferior officers subject to Article II. Hill makes the additional assertion that an agency official can be an inferior officer even if their decisions lack finality. For this point, Hill cites the Supreme Court's *Edmond* opinion, which dealt mostly with the question of who is a principal officer.

For its part, the SEC argues that its ALJs are no different than the non-final ALJs at the Federal Deposit Insurance Corporation. The D.C. Circuit in *Landry* held the FDIC's ALJs were employees.

The case is No. 15-12831.

Attorneys: Megan Barbero, U.S. Department of Justice, for the SEC. Stephen E. Hudson (Kilpatrick Townsend & Stockton LLP) for Charles L. Hill, Jr.

Companies: Raymond J. Lucia Companies

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