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Supreme Court allows upfront constitutional challenges to FTC and SEC proceedings

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On April 14, a unanimous Supreme Court held that parties can challenge the constitutionality of the FTC's and SEC's administrative proceedings in federal court *before* an agency review is complete. This is not a decision on the constitutionality of these proceedings. But removing the requirement on parties to first exhaust administrative processes will facilitate parties' ability to seek relief and will likely hasten the day when the Supreme Court *does* decide if these courts are constitutional.

The Supreme Court's decision

On April 14, 2023, a unanimous Supreme Court held that federal district courts can hear challenges to the constitutionality of the Federal Trade Commission's (the FTC) and the Securities and Exchange Commission's (the SEC) administrative proceedings held before an administrative law judge (ALJ) prior to the conclusion of a challenged administrative action. The Court's decision is captioned *Axon Enterprises, Inc. v. Federal Trade Commission, et al*.[1]

The Supreme Court's decision resolved a circuit split. In *Axon Enterprise, Inc. v. Federal Trade Commission, et al.*, the Ninth Circuit affirmed dismissal of Axon's argument that an FTC administrative proceeding is unconstitutional, on the grounds that Congress precluded the district court from hearing Axon's constitutionality arguments.[2] Even in doing so, the majority noted that, "[i]t seems odd to force a party to raise constitutional challenges before an agency that cannot decide them."[3] In *Securities and Exchange Commission, et al. v. Cochran*, the Fifth Circuit decided *en banc* that district courts have jurisdiction to hear constitutional claims prior to a final agency decision.[4]

The Supreme Court's decision did not address the actual constitutionality of the FTC's and SEC's administrative adjudications. Justice Kagan, writing for the majority, noted, "[o]ur task today is not to resolve those challenges; rather, it is to decide where they may be heard."[5]

Relatedly, it is important to note that a separate Fifth Circuit case, *Securities and Exchange Commission v. Jarkesy*, found that the SEC's administrative court did violate various constitutional protections, including the Seventh Amendment right to a jury trial, but *Jarkesy* was not at issue in the Supreme Court's *Axon* opinion.[6]

FTC and SEC procedural background

The FTC can sue to enforce the Federal Trade Commission Act (the FTC Act) in federal district court or in the agency's own administrative tribunal. The SEC has similar rights under the federal securities laws. The FTC's and SEC's in-house tribunal processes are quite similar.

If an agency brings suit in administrative court, the matter typically is heard by an ALJ, whose decision can be appealed to the full Commission.[7] At the SEC, the Commissioners can also sit as the trial court, in lieu of delegating the case to an ALJ, though this option has practical limitations and the SEC Commissioners are likely unable to hear multiple cases

simultaneously. Both the FTC Act and the federal securities laws then allow parties to appeal a Commission decision to a federal circuit court.[8] In *Axon* and *Cochran*, the agencies argued that federal courts lack jurisdiction to rule on administrative actions, including on the constitutionality of those actions, until the agency completes its underlying proceedings.

The Court's *Axon* and *Cochran* analysis

Congress grants federal district courts "original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."[9] At the same time, Congress can limit district courts' review by authorizing agencies to assign initial review to their own in-house tribunal. In the latter situation, a party must raise its arguments with the agency itself, before review by a federal court.

The key question before the Supreme Court was whether the constitutionality claims being brought by Axon and Cochran are "of the type Congress intended to be reviewed within th[e] statutory structure" of the Commissions' administrative tribunals.[10] If so, then federal court review must await a final agency action. If not, then a party may seek immediate review on its constitutionality claims in federal court.

In *Thunder Basin Coal Co. v. Reich*,[11] the Court established a three-part test for determining whether a statute precludes a district court from exercising jurisdiction, where: (1) preclusion could "foreclose all meaningful judicial review"; (2) the claim is "wholly collateral to [the] statute's review provisions"; and (3) the claim is "outside the agency's expertise."[12] Applying these factors here, the Court found that:

1. The ability of the FTC and SEC to divert these constitutional challenges to the administrative process "foreclos[ed] all meaningful judicial review of the claim,"[13] because the point of the challenge was to avoid "being subjected to an illegitimate proceeding" in the first place.[14]
2. The challengers' claims are "wholly collateral"[15] to the statute's review provisions, since a constitutional challenge to the Commissions' authority has nothing to do with the alleged violations of the FTC Act or the federal securities laws.[16]
3. Constitutionality claims "fall outside the Commissions' sphere of expertise."[17] The FTC and SEC know "nothing special about the separation of powers," the crux of the issue.[18]

The Supreme Court concluded that all three *Thunder Basin* factors clearly indicate that the constitutional claims being asserted by Axon and Cochran are "not of the type the [FTC and SEC] statutory review schemes reach," and "[a] district court can therefore review them" before a final agency decision.[19]

Likely implications for agency practice

The Court was clear that it was not ruling on the constitutionality of the FTC or the SEC administrative trials. It may be some time before that issue is fully resolved by the courts, and as previously discussed, the Fifth Circuit has already taken the position in *Jarkesy* that SEC administrative proceedings violate constitutional protections—a ruling that calls the FTC's administrative process into question. In the near term, however, and before resolution of the constitutionality question, some implications from the Court's ruling are likely.

First, Axon will likely continue its challenge to the constitutionality of the FTC's administrative process. Cochran may take a similar approach before the SEC. By removing a procedural barrier to parties challenging the constitutionality of FTC or SEC administrative trials, the Court has decreased the burdens on parties to raise these challenges. As a result, it would not be surprising to see additional constitutionality challenges against the FTC or SEC, such as from parties like Illumina, Inc. and GRAIL, Inc. (who recently received an unfavorable "appellate" decision by the FTC Commissioners

that is now on appeal to the Fifth Circuit)[20] or Microsoft Corp. and Activision Blizzard, Inc. (who are currently undergoing trial before an FTC ALJ).

Second, the FTC and SEC may bring more cases in district court to avoid first-order constitutional challenges to agency proceedings. For the FTC, a move to federal court risks undermining the agency's aggressive enforcement agenda. Federal courts have generally been less accepting of more aggressive, nontraditional theories of antitrust harm, evidenced by a number of recent losses by the FTC (and the Department of Justice Antitrust Division (DOJ)[21]) in both merger and conduct cases.[22] Going to federal court raises a particular question about the FTC's "unfair methods of competition" enforcement under FTC Act Section 5, for which the FTC recently announced a policy taking an expansive view of liability and asserting a much more FTC-friendly legal standard.[23] Lastly, bringing cases in district court also removes the Commissioners' ability to "correct" unfavorable decisions in their own administrative court.

For the SEC, the Commission appears to have reduced the number of filings of contested administrative proceedings since the constitutional questions were raised. In several administrative proceedings, the SEC appears to have delayed assigning cases to an ALJ. Not relying on ALJs might temporarily forestall court challenges, but it would be difficult for the SEC Commissioners to administer multiple administrative proceedings, including trials, without assigning them to ALJs. Sending more securities cases to federal court, instead of using the SEC's in-house proceedings, could have a significant impact on the SEC's enforcement program, since there are certain remedies that the SEC may obtain only in an administrative proceeding, not district court.

Third, if the FTC or SEC bring an action before an ALJ, then the agencies should expect a parallel constitutionality challenge in federal court that could slow down the administrative proceeding. Parties challenging agency process constitutionality may request stays of the agency process, which could put a pause on the in-house merits adjudication pending an outcome on constitutionality. For instance, the Ninth Circuit granted Axon's request to stay the FTC proceeding.[24] These challenges also could result in additional district court orders finding the administrative processes to be unconstitutional.

Lastly, it remains to be seen whether the Supreme Court's decision opens the door to constitutional challenges to administrative proceedings before other government agencies.

Key takeaways

The *Axon* and *Cochran* decisions remove a key procedural defense raised by the government (exhaustion of administrative processes) that until now prevented private parties from obtaining faster and less costly consideration of constitutional challenges to FTC and SEC administrative proceedings. Should parties win such challenges, there would likely be major changes in agency procedures. In the meantime, the *potential* for the FTC and SEC ALJ tribunals to be found unconstitutional will have immediate impacts. In particular, it may lead the FTC and SEC to bring more cases in federal court, which could have important implications on the agencies' enforcement programs.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] *Axon Enterprise, Inc. v. Federal Trade Commission, et al.*, 598 U.S. __ (2023) (hereinafter *Axon*).

[2] *Axon* involved an acquisition by Axon of a competitor. The transaction was not subject to HSR Act review and closed. The FTC sued in administrative court to unwind the transaction. Prior to an ALJ decision, Axon filed a federal court complaint alleging that (1) ALJs' "dual level" of protections from Presidential removal violates Article II of the Constitution, (2) Commissioners having the ability to bring a case and then hear an appeal on that case violates parties' right to due process, and (3) the FTC and Department of Justice Antitrust Division "utilize an arbitrary and irrational 'clearance' process when deciding which agency will review a particular acquisition," violating parties' right to equal protection. *Axon Enterprise Inc. v. Federal Trade Commission*, 452 F.Supp.3d 882, 886 (D. Ariz. 2020). The district court dismissed Axon's complaint, and Axon appealed. The Ninth Circuit affirmed the dismissal

[3] *Axon Enterprise, Inc. v. Federal Trade Commission*, 986 F.3d 1173, 1183 (9th Cir. 2021).

[4] *Cochran* involved an accountant accused of failing to comply with applicable auditing standards. An SEC ALJ had already ruled that Cochran violated federal securities laws when the Supreme Court decided *Lucia v. Securities and Exchange Commission*, 138 S.Ct. 2044 (2018), which held that SEC ALJs were improperly appointed by SEC staff. This led the SEC to order a new hearing for Cochran with a validly appointed ALJ. Before this *second* ALJ trial began, Cochran filed a complaint in federal court asserting that the SEC's use of ALJs (1) violates Article II of the Constitution, and (2) contravenes the SEC's own rules and procedures, which constitutes a violation of the right to due process. *Cochran v. Securities and Exchange Commission*, 969 F.3d 507, 510 (5th Cir. 2020). The district court dismissed Cochran's complaint, but the Fifth Circuit (sitting *en banc*) reversed.

[5] *Axon*, at 2.

[6] *See* Davis Polk, Fifth Circuit holds the SEC's administrative adjudications to be unconstitutional (May 25, 2022), https://www.davispolk.com/insights/client-update/fifth-circuit-holds-secs-administrative-adjudications-be-unconstitutional.

[7] U.S.C. §78d–1(a); note following §41; 16 C.F.R. §§3.52–3.54; 17 C.F.R. §§201.410–201.411; *Axon*, at 2-3.

[8] U.S.C. §78y(a)(1), (3); U.S.C. §45(c); *Axon*, at 3.

[9] 28 U.S.C. § 1331.

[10] *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212 (1994).

[11] 510 U.S. 200 (1994).

[12] *Axon*, at 8 (citing *Thunder Basin*, 510 U.S., at 212-213).

[13] *Thunder Basin*, at 212-213.

[14] *Axon*, at 13.

[15] *Thunder Basin*, at 212.

[16] *Axon*, at 15. The Court relied on the similar decision made on this point in *Free Enterprise Fund v. Public Company Accounting Oversight Bd*., 561 U.S. 477, 490 (2010).

[17] *Axon*, at 18.

[18] *Id.*, at 16-17.

[19] *Id*., at 18.

[20] On April 3, the FTC Commissioners announced a decision to block Illumina's vertical acquisition of GRAIL, overturning the FTC ALJ that had held the merger could proceed. Illumina filed a notice of appeal with the Fifth Circuit, which the court has agreed to hear on an expedited schedule. Order Granting Petitioners' Opposed Motion to Expedite the Proceeding, *Illumina, Inc. and GRAIL, Inc., v. Federal Trade Commission*, No. 23-60167 (5th Cir. Apr. 18, 2023). Illumina's constitutionality arguments (previously raised in front of, and rejected by, the Commissioners) will likely be an important part of the appeal.

[21] The DOJ shares federal antitrust enforcement authority with the FTC, but can only bring cases in federal court.

[22] As a recent example, the Northern District of California ruled against the FTC in its challenge to Meta Platform Inc.'s proposed acquisition of Within Unlimited. The FTC's case was premised on a theory of potential future competition between Meta and Within. The court ruled that the FTC had not shown a likelihood of harm to competition based on the FTC's theory—but, of note, the court did not hold that potential competition theories could never be a basis for liability. The FTC has announced that it will not appeal the district court's decision.

For more discussion on the FTC's increasingly aggressive enforcement, please see Davis Polk's client updates: Three recent merger enforcement decisions signal challenges for U.S. antitrust agencies and President Biden's Executive Order on Competition: One year later.

[23] *See* Davis Polk, FTC interprets "unfair competition" broadly in new Section 5 policy statement (Nov. 15, 2022), https://www.davispolk.com/insights/client-update/ftc-interprets-unfair-competition-broadly-new-section-5-policy-statement.

[24] *See* Order, *Axon Enterprises, Inc. v. FTC.*, No. 20- 15662 (9th Cir., filed Oct. 2, 2020); *see also* Order Staying Commencement of Evidentiary Hearing, *In re Axon Enterprise, Inc.*, FTC Dkt. No. 9389 (Oct. 8, 2020).