

U.S. SUPREME COURT EMPOWERS DEFENDANTS TO MOUNT CONSTITUTIONAL CHALLENGES TO FTC AND SEC IN-HOUSE COURTS

Earlier this month, in *Axon Enterprise, Inc. v. Federal Trade Commission*,¹ the U.S. Supreme Court unanimously held that defendants may ask federal courts to halt administrative enforcement actions brought against them by the Securities and Exchange Commission ("**SEC**") or the Federal Trade Commission ("**FTC**"), on the grounds those claims are unconstitutional. Neither agency may force defendants to entrust the agencies' administrative judges to resolve such "existential" challenges to their own authority.

On its own, that holding is impactful and will certainly make it easier for parties to challenge the historically unchecked power of certain federal agencies on constitutional grounds. However, the potential implications of the *Axon* decision are even more far-reaching. As the latest in a series of Supreme Court decisions to cabin the reach of the administrative state, *Axon* strikes a blow to both agencies' longstanding practices of pursuing enforcement actions in friendly, in-house settings, where their long records of success suggest each agency has benefitted from a "homefield advantage" divorced from the merits of any given case. At a moment when both agencies are aggressively testing the boundaries of their respective mandates, *Axon* should embolden parties to step outside of those in-house proceedings to ask the federal courts to curb agency overreach, and it may shape the types of actions agencies choose to bring altogether.

¹ *Axon Enter., Inc. v. Fed. Trade Comm'n*, 598 U.S. ___, 2023 WL 2938328 (Apr. 14, 2023).

BACKGROUND

Parties who have had to defend themselves from an FTC or SEC administrative claim would likely agree with Justice Neil Gorsuch's observation that the cases have always seemed "tilted" in the agencies' favor (or as the Ninth Circuit stated, "the FTC has stacked the deck" in its administrative proceedings). For good reason. Historically, these administrative proceedings have almost entirely insulated the agencies from accountability, resulting in both agencies bringing what some would argue are meritless actions that would never pass muster in federal court.

At the outset, when the FTC or SEC decides to bring an administrative action against a company, the respective commissions initiate the actions via vote. They are then tried by the agencies' staff in their own administrative courts—parties do not have the option of a hearing before an impartial Article III judge. The cases are then heard by the agencies' administrative law judges ("**ALJs**"), who employ "relaxed rules of procedure and evidence" written by the commissions themselves. When losing parties appeal the ALJ's decision, they find themselves in front of the very same commissioners who recommended the action against them in the first place. Not until the commission issues a final decision ratifying (or reversing) the ALJ—sometimes, years after an investigation began—may a losing party finally obtain review by an independent federal appeals court. Even that review is highly deferential to the agency decision.

Given the agencies' inherent advantages, it's no surprise that they have found success on their home turf and almost always win. The record in *Axon* reflected that the FTC has ruled in favor of itself after trial on appeal—either affirming the ALJ when it wins or reversing the ALJ when it loses—nearly 100% of the time in the past 25 years, and the SEC fared nearly as well in its own administrative proceedings. This success rate is far better than either agency has performed in federal court. It's understandable that defendants facing the long odds of an administrative action might prefer to ask a federal court to block the proceeding altogether.

AXON AND COCHRAN

The Supreme Court's *Axon* [opinion](#) addressed two cases—*Axon v. FTC* and *Cochran v. SEC*—each of which tested whether the administrative review schemes in the Securities Exchange Act of 1934 ("**Exchange Act**") and the Federal Trade Commission Act ("**FTC Act**") implicitly divest the federal district courts of jurisdiction to entertain constitutional attacks on agency authority.

In *Axon*, a body camera manufacturer (Axon) sued to halt an FTC administrative proceeding that the government initiated after the closing and announcement of its acquisition of a small competitor (Viewu). After an eighteen-month investigation, Axon offered to divest the acquired Viewu assets and walk away from the transaction. The FTC rejected this offer and proposed an alternative settlement—as described by Axon, that "Axon turn Viewu into a 'clone' of Axon using Axon's intellectual property" or face an administrative proceeding.² Axon then brought constitutional claims against the FTC in federal district court in Arizona.

² Brief for Petitioner at 12, *Axon Enter., Inc. v. FTC*, No. 21-86 (May 9, 2022).

Specifically, Axon asserted that (1) the tenure protections afforded to ALJs improperly shielded them from Presidential oversight in violation of Article II of the U.S. Constitution; and (2) the FTC's dual roles as prosecutor and judge violated constitutional separation-of-powers principles. The FTC initiated an administrative proceeding that same day, and Axon sought to enjoin the administrative proceeding in the district court pending its previously asserted constitutional claims.

In *Cochran*, an accountant asked a different federal court to block an SEC administrative action against her, raising a nearly identical challenge to ALJ independence.

Both district courts dismissed the claims. Each held that by codifying a regime of administrative enforcement and appellate review, Congress had "implicitly" divested the district courts of jurisdiction over challenges to agency proceedings under the Exchange Act or FTC Act.

But the cases diverged on appeal. In *Axon*, the appellate court affirmed the district court's dismissal for lack of jurisdiction. But in *Cochran*, a different appeals court reversed dismissal, holding that the accountant's constitutional attack on the independence of the ALJ "is not the type of claim Congress intended to funnel through the Exchange Act's statutory-review scheme." The Supreme Court took up the cases to resolve that split.

THE SUPREME COURT'S DECISION

The *Axon* Court unanimously concluded that neither Act precludes a district court from assessing constitutional challenges to the agencies' enforcement authority. Writing for the Court, Justice Elena Kagan relied on the so-called "*Thunder Basin*" factors—deriving from *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200 (1994)—for assessing whether the parties' claims were "of the type" that Congress had intended to (implicitly) direct away from the courts and toward the agencies. The *Axon* Court found that none of those factors favored the agencies.

First, precluding district court jurisdiction over the parties' constitutional challenges would foreclose "meaningful judicial review" of those claims. The Court focused on "the interaction between the alleged injury and the timing of review": the harm alleged by the parties—having to subject themselves to unconstitutional agency authority—is a "here-and-now injury" that is "impossible to remedy once the proceeding is over." By the time an appeals court could review that constitutional challenge, it would be too late to undo the harm.

Second, the parties' constitutional challenges were "wholly collateral" to the agencies' enforcement authority. The Court explained that the parties had objected "to the Commissions' power generally." They had not raised "procedural or evidentiary" challenges to the agencies' decision making, which go to the more commonplace challenge to "how [agency] power was wielded."

Third, respondents' constitutional challenges fell far outside of the agencies' respective "sphere[s] of expertise." While the FTC knows plenty about promoting competition, and the SEC about protecting investors, the agencies know "nothing special about the separation of powers" that would suggest Congress intended to reserve such constitutional questions for agency review.

Accordingly, the *Axon* Court returned each case to the lower courts to resolve the parties' constitutional challenges.

CONCURRING OPINIONS

Two justices wrote separately to suggest more fundamental reasons why the district courts could hear the parties' constitutional challenges.

Justice Clarence Thomas expressed "grave doubts" that Congress has the power to authorize administrative enforcement proceedings in the first place. He explained that the system of "primary adjudication by an executive agency subject to only limited Article III review" is "unlike the system that prevailed for the first century of our Nation's existence." Drawing on that earlier system, he said "core private rights," such as "life, liberty, and property," can "likely" be adjudicated only by Article III courts, and that the administrative review process violates constitutional safeguards found in Articles II and III, separation-of-power principles, due process, and the Seventh Amendment right to jury trial.

Justice Neil Gorsuch separately said that actions fell within the federal courts' authority to resolve civil disputes arising under the Constitution or laws of the United States and does not depend on the "judge-made, multi-factor balancing test" on which the Court had relied.

TAKEAWAYS

Axon is a momentous decision for several reasons. While not a ruling on the merits of whether FTC or SEC enforcement proceedings are themselves constitutional, the *Axon* decision all but ensures that question will soon be litigated in response to future attacks on the agencies' structures. In the near term, the decision could discourage agencies from pursuing an action in an in-house setting, to avoid situations where defendants are likely to go to federal court to seek relief from what the Court has now unanimously agreed is a "here-and-now" injury. Defendants that raise such challenges in federal court can draw on the more sweeping concurrences here, particularly Justice Thomas's, as a roadmap of arguments that may appeal to originalist justices amenable to further narrowing the agencies' enforcement powers.

FTC Considerations

FTC Chair Lina Khan has already made it clear that she intends to continue to push the limits of Section 5 of the FTC Act, and until the Supreme Court's *Axon* decision, courts had limited power to check this overreach. Indeed, parties simply did not have the ability to challenge the process as unconstitutional in federal court prior to going through a costly and time-consuming administrative hearing. This resulted in most parties settling—and often on worse terms than what they'd likely get if the case were in federal court. Going forward, we expect more parties will challenge actions on constitutional grounds at the outset, thus testing the limits of this decision.

However, the importance of the opinion should also not be overstated. The same process for voting out administrative complaints which we describe above is still in place; this opinion does nothing to change that. The decision does nothing to curb the FTC's investigatory power and will not stop the agency from bringing administrative actions; the primary difference now is that at least some parties

have another tool to fight back. Substantively, the more interesting question will be how future courts will view *Axon*, and whether federal courts will trend towards Justice Thomas's concurrence—which raised significant concerns regarding the constitutionality of the entire appellate review model of agency adjudication—or strictly apply the standard laid out by the majority.

SEC Considerations

We may not need to wait long to see how the Court views the constitutionality of SEC enforcement proceedings. In another recent decision, the same appeals court that ruled in favor of Cochran vacated a decision in a separate SEC enforcement action, on the grounds that (1) the SEC had violated the defendant's Seventh Amendment right to a trial by jury; (2) the SEC's ability to choose between district court and administrative adjudication of such a claim amounted to an unconstitutional delegation of legislative authority; and (3) the restriction on removing SEC ALJs only for cause violated Article II's Take Care Clause.³ The SEC has asked the Supreme Court to review the decision; that request remains pending.

In the meantime, *Axon's* impact is already being felt in the financial sector. This week, at least one defendant in a pending SEC administrative proceeding has already cited *Axon* as grounds for a federal court challenge to the constitutionality of the agency's enforcement power. Expect this trend to continue.

³ *Jarkesy v. Sec. & Exch. Comm'n*, 34 F.4th 446 (5th Cir. 2022).

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