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Supreme Court Rules That Federal District Courts Can Resolve Constitutional Challenges to FTC and SEC Structure

The Supreme Court's Unanimous Decision Allowing Private Parties to Bypass Administrative Proceedings for Constitutional Claims Could Increase Challenges to the FTC and SEC's In-House Adjudications

SUMMARY

On April 14, 2023, in an opinion by Justice Kagan, the U.S. Supreme Court held in *Axon Enterprise, Inc. v. FTC*, 596 U.S. ___, 2023 WL 2938328 (Apr. 14, 2023), that federal district courts have jurisdiction to adjudicate constitutional challenges to the structure of the Federal Trade Commission (FTC) and the Securities and Exchange Commission (SEC). In reaching that decision, the Court rejected the government's position that plaintiffs must first pursue such claims in administrative proceedings and then seek review in a court of appeals. The Court's decision paves the way for federal district courts to rule on a range of constitutional challenges to the structure of administrative agencies, including whether the FTC's and SEC's Administrative Law Judges (ALJs) are too insulated from political accountability and whether the FTC may serve as both prosecutor and adjudicator in its own administrative proceedings. Although the Court did not address the merits of the plaintiffs' constitutional claims, this decision ensures that lower federal courts will be asked to resolve those claims in the near future.

BACKGROUND

In *Axon* and its companion case, *SEC v. Cochran*, private respondents in administrative enforcement proceedings before the FTC and SEC brought separate lawsuits in federal district court alleging that the agencies' proceedings against them were unconstitutional. In both cases, the government objected that the plaintiffs could not pursue their claims in federal district court because the review schemes set forth in the

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Securities and Exchange Act (Exchange Act) and the Federal Trade Commission Act (FTC Act)—which provide for review in the federal courts of appeals only after agency proceedings have concluded—are exclusive.

Axon involved an FTC enforcement action alleging that Axon Enterprise violated the antitrust laws by acquiring its closest competitor. After the agency brought the enforcement action, Axon filed a motion for injunctive relief in federal district court, arguing both that (i) the FTC’s ALJs are unconstitutional because they enjoy too much independence from any politically accountable official, and (ii) the FTC’s administrative proceedings are unconstitutional because the FTC exercises both prosecutorial and adjudicative functions in the same case. The district court dismissed Axon’s suit for lack of jurisdiction, agreeing with the government that the judicial review procedures of the FTC Act barred the court from hearing Axon’s case.¹ The Ninth Circuit affirmed.²

In *Cochran*, the SEC brought an enforcement action against Michelle Cochran, a certified public accountant, for failure to comply with auditing standards under the Exchange Act. Before the SEC hearing started, Cochran sued in federal district court. Like Axon, she argued that the SEC’s ALJs are too insulated from political accountability and thus violate the constitutionally mandated separation of powers. Although the district court dismissed the suit,³ the en banc Fifth Circuit reversed.⁴ The Fifth Circuit reasoned that Cochran’s separation-of-powers challenge to the SEC’s ALJs “is not the type of claim Congress intended to funnel through the Exchange Act’s statutory-review scheme.”⁵

THE U.S. SUPREME COURT’S DECISION

The Supreme Court sided with Axon and Cochran, with all nine Justices agreeing that their separate lawsuits were not barred. The Court looked to its earlier decision in *Thunder Basin Coal Co. v. Reich*,⁶ which identified three factors to apply when determining whether a statutory review scheme prevents federal district courts from exercising their general federal-question jurisdiction. On the first factor—whether “preclusion of district court jurisdiction ‘could foreclose all meaningful judicial review’”⁷—the Court reasoned that requiring Axon and Cochran to first raise their claims before the agency would compel them to participate in what they allege to be an unconstitutional proceeding. And that injury would be “impossible to remedy once the proceeding is over.”⁸ On the second factor—whether the challenges are “collateral” to the agency proceedings—the Court held that because Cochran and Axon “are challenging the Commissions’ power to proceed at all, rather than actions taken in the agency proceedings,” their claims were collateral.⁹ On the third factor—whether the claims implicate the agency’s expertise—the Court noted that agencies do not have special expertise in constitutional and administrative questions about the separation of powers.¹⁰

After applying these factors, the Court held that federal district courts could review “Axon’s and Cochran’s claims that the structure, or even existence, of an agency violates the Constitution.”¹¹ But the Court was

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careful to note that Axon's and Cochran's claims challenged " 'here-and-now' injury of subjection to an unconstitutionally structured decisionmaking process," as opposed to "the commonplace procedures agencies use" and "the sorts of procedural or evidentiary matters an agency often resolves on its way to a merits decision."¹² The Court did not reach the merits of either of the constitutional challenges raised by Axon or Cochran.

Justices Thomas and Gorsuch filed separate opinions. Justice Thomas, the only Justice who addressed the merits of Axon's and Cochran's claims, joined the majority opinion in full and also filed a concurring opinion expressing "grave doubts about the constitutional propriety of Congress vesting administrative agencies with primary authority to adjudicate core private rights with only deferential judicial review on the back end."¹³ Justice Gorsuch concurred only in the judgment because he disagreed with the majority opinion's reasoning.¹⁴ Instead of relying on *Thunder Basin*, which he characterized as an improper attempt to engage in "jurisdiction-stripping-by-implication,"¹⁵ Justice Gorsuch reasoned that Axon's and Cochran's claims belong in federal district court under 28 U.S.C. § 1331, which gives federal district court jurisdiction to resolve "civil actions arising under the Constitution, laws, or treaties of the United States."

IMPLICATIONS

Although the *Axon* decision did not take a position on the constitutional challenges to (1) the removal protections of ALJs at the SEC and the FTC or (2) the FTC's combined executive and judicial functions, it teed up those challenges for adjudication in federal district courts on remand. More generally, the *Axon* decision will make it easier for litigants to pursue claims challenging the structure of the FTC and SEC in federal court. For both agencies, *Axon* will likely accelerate challenges to the process by which ALJs are appointed and removed. The SEC has recently faced a number of constitutional challenges to its structure, including *Lucia v. SEC*,¹⁶ in which the Supreme Court held that the SEC's ALJs were subject to the Constitution's Appointments Clause, and had not been properly appointed. The *Axon* decision will likely precipitate further challenges to the SEC's structure and the nature of its proceedings.

For the FTC, the holding may portend broader attacks on the agency. In recent years, the FTC has sought to block a number of mergers through its own agency adjudications against a backdrop of court decisions rejecting the FTC's (and the Department of Justice's) increasingly aggressive approach to antitrust enforcement under the Biden Administration. Following *Axon*, interested parties will be able to raise structural constitutional challenges to the FTC's in-house agency-adjudication process in federal district court. Although the Court's decision in *Axon* did not take a position on the merits of those claims, it did increase the likelihood that courts will be asked to decide those questions in the near future. The Court's holding could also complicate mergers and acquisitions. For instance, parties may wish to include in their merger agreements covenants respecting the potential litigation of these kinds of constitutional claims.

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Similarly, the potential for this kind of litigation has implications for the timing provisions of a merger agreement.

Lastly, the *Axon* decision is unlikely to have any bearing on statutes that contain an explicit withdrawal of jurisdiction from federal district courts, such as the Federal Deposit Insurance Act.¹⁷ The analysis in *Axon* concerns statutes such as the Exchange Act and the FTC Act, which do not contain explicit carve-outs, thereby requiring the Court to engage in *Thunder Basin's* three-prong inquiry to determine whether the claims are “‘of the type’ Congress thought belonged within a statutory scheme.”¹⁸

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ENDNOTES

- 1 *Axon Enter. Inc. v. FTC*, 452 F. Supp. 3d 882 (D. Ariz. 2020).
- 2 *Axon Enter., Inc. v. FTC*, 986 F.3d 1173 (9th Cir. 2021).
- 3 *Cochran v. SEC*, 2019 WL 1359252 (N.D. Tex., Mar. 25, 2019).
- 4 *Cochran v. SEC*, 20 F.4th 194 (5th Cir. 2021) (en banc).
- 5 *Id.* at 207.
- 6 510 U.S. 200 (1994).
- 7 *Axon Enter., Inc.*, 2023 WL 2938328, at *2 (quoting *Thunder Basin Coal Co.*, 510 U.S. at 212–213).
- 8 *Axon Enter., Inc.*, 2023 WL 2938328, at *2.
- 9 *Id.* at *9.
- 10 *Id.* at *10.
- 11 *Id.*
- 12 *Id.* at *8–*9.
- 13 *Id.* at *11 (Thomas, J., concurring).
- 14 *Id.* at *14 (Gorsuch, J., concurring in judgment).
- 15 *Id.* at *16.
- 16 585 U. S. ____, (2018).
- 17 12 U.S.C. § 1818(i)(1) (“[E]xcept as otherwise provided in this section or under section 1831o or 1831p–1 of this title no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under any such section.”); see also *Axon Enter., Inc.*, 2023 WL 2938328, at *14 (Gorsuch, J., concurring in judgment) (identifying 12 U.S.C. § 1818(i)(1) as an instance where Congress expressly withdrew jurisdiction from federal district courts).
- 18 *Axon Enter., Inc.*, 2023 WL 2938328, at *8 (quoting *Thunder Basin Coal Co.*, 510 U.S. at 212).

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