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# Fifth Circuit Holds That District Courts May Hear Structural Constitutional Challenges to Ongoing SEC Enforcement Actions

Federal district courts are imbued with “original jurisdiction” over “all civil actions arising under the Constitution, laws, or treaties of the United States.” 28 U.S.C. § 1331. The Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78y, however, provides that “[a] person aggrieved by a final order of the [Securities and Exchange Commission (“SEC”)] may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit.” In recent years, several circuit courts of appeals have held that this provision of the Exchange Act implicitly strips federal district courts of subject matter jurisdiction to hear challenges to ongoing SEC enforcement proceedings.

Contrary to the holding of each circuit court of appeals that has previously considered the issue,<sup>1</sup> and following a rehearing *en banc*, the United States Court of Appeals for the Fifth Circuit in *Cochran v. SEC*, 20 F.4th 194 (5th Cir. 2021) (*en banc*), held that 15 U.S.C. § 78y did not explicitly or implicitly strip the district court of subject matter jurisdiction over the plaintiff’s claim alleging that the SEC Administrative Law Judge (“ALJ”) presiding over an enforcement action against her is unconstitutionally insulated from the President’s Article II removal power. Breaking with other circuits, the Fifth Circuit held that section 78y did not divest the district court of jurisdiction to hear “structural constitutional claims” and that district courts may entertain such challenges to SEC authority that do not depend on the validity of any substantive aspect of the Exchange Act or any SEC rule, regulation, or order.

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## I. Factual and Procedural Background

In April 2016, the SEC brought an enforcement action against Michelle Cochran, a certified public accountant. The SEC alleged that Cochran violated the Exchange Act by failing to comply with Public Company Accounting Oversight Board (“PCAOB”) auditing standards when performing quarterly reviews and annual audits between 2010 and 2013. Following a hearing, an SEC ALJ ruled against Cochran, imposing a \$22,500 penalty and banning her from practicing before the SEC for five years. The SEC adopted the ALJ’s decision, and Cochran objected.

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<sup>1</sup> See *Tilton v. SEC*, 824 F.3d 276, 281–91 (2d Cir. 2016) (applying the *Thunder Basin* factors (see footnote 5, *infra*) and concluding that the Exchange Act precluded district court jurisdiction over an Appointments Clause challenge to an ongoing SEC proceeding); *Bennett v. SEC*, 844 F.3d 174, 186 (4th Cir. 2016) (applying the *Thunder Basin* factors and concluding that section 78y precluded district court jurisdiction over an Appointments Clause challenge relating to an ongoing enforcement proceeding); *Bebo v. SEC*, 799 F.3d 765, 774–75 (7th Cir. 2015) (same); *Hill v. SEC*, 825 F.3d 1236, 1248, 1252 (11th Cir. 2016) (same); *Jarkesy v. SEC*, 803 F.3d 9, 20, 30 (D.C. Cir. 2015) (holding that section 78y precluded district court jurisdiction over various constitutional challenges to an ongoing SEC enforcement action).

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Before the SEC ruled on Cochran's objection, the United States Supreme Court issued its opinion in *Lucia v. SEC*,<sup>2</sup> which held that, because SEC ALJs are officers of the United States under the Appointments Clause, they must be appointed by the President, a court of law, or a department head. In response to *Lucia*, the SEC remanded all pending administrative law cases, including Cochran's, for new proceedings before constitutionally appointed ALJs.<sup>3</sup>

Following reassignment of Cochran's case to a new ALJ, Cochran filed suit in the United States District Court for the Northern District of Texas, seeking to enjoin the SEC's enforcement proceedings against her. Cochran alleged that, because the SEC ALJs enjoy multiple layers of "for-cause" removal protection, they are unconstitutionally insulated from the President's Article II removal power (Cochran's "removal power claim").<sup>4</sup>

On March 25, 2019, the district court dismissed Cochran's claim for lack of subject-matter jurisdiction, holding that because Exchange Act section 78y permits judicial review of final SEC orders in certain circuit courts of appeals, the Exchange Act implicitly strips district courts of jurisdiction to hear challenges regarding ongoing SEC enforcement proceedings. *Cochran v. SEC*, No. 4:19-CV-066-A, 2019 WL 1359252 (N.D. Tex. Mar. 25, 2019). In the district court's view, Cochran had to first raise her constitutional claim in the SEC proceeding and then petition for review in the Fifth Circuit or the District of Columbia Circuit if the proceeding resulted in an adverse ruling.

On August 11, 2020, a divided Fifth Circuit panel affirmed the district court's dismissal of Cochran's claim for lack of subject matter jurisdiction. *Cochran v. SEC*, 969 F.3d 507 (5th Cir. 2020). The Fifth Circuit joined each of the five circuit courts of appeals that has previously considered the issue and held that a party may not raise a constitutional challenge to an SEC enforcement action in federal district court before the agency proceeding ends. The court, in an opinion authored by Judge Costa, held that the text and structure of the Exchange Act exhibited a general intent to deprive district courts of subject matter jurisdiction and, after considering each of the "*Thunder Basin*" factors,<sup>5</sup> that Congress intended that constitutional challenges to SEC enforcement actions, like those raised by Cochran, follow the common path for judicial review of agency action—appeal to the court of appeals after an agency ruling. Judge Haynes dissented, stating that Cochran's claim was "not the type over which Congress intended to limit judicial review." *Id.* at 518. On October 30, 2020, the Fifth Circuit granted rehearing *en banc* to determine whether the district court had subject matter jurisdiction over Cochran's removal power claim.<sup>6</sup>

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## II. The Fifth Circuit's *En Banc* Decision

On December 13, 2021, the *en banc* court reversed the prior panel, holding that section 78y did not strip the district court of its jurisdictional power to hear "all civil actions arising under the Constitution," 28 U.S.C. § 1331, including Cochran's removal power claim. *Cochran*, 20 F.4th at 199. Examining the text of section 78y, Supreme

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<sup>2</sup> 138 S. Ct. 2044 (2018); see also our firm memorandum on this decision, which can be found [here](#).

<sup>3</sup> In an attempt to cure the constitutional issues raised in *Lucia*, the SEC ratified the appointment of all of its ALJs.

<sup>4</sup> The Court in *Lucia* declined to reach this removability issue. *Lucia*, 138 S. Ct. at 2050 n.1.

<sup>5</sup> In *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212-13 (1994), the Supreme Court set forth three factors for courts to consider in determining whether Congress intended to preclude initial judicial review by creating a statutory framework that delegates initial review to an administrative agency: (1) whether the plaintiff can obtain meaningful judicial review in the statutory scheme, (2) whether the claim is wholly collateral to the statutory scheme, and (3) whether the claim is outside the agency's expertise.

<sup>6</sup> Although Cochran also asserted a due process claim, she abandoned the claim by failing to challenge the district court's dismissal of her due process claim in her *en banc* briefing. *Cochran*, 20 F.4th at 199 n.4.

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Court precedent interpreting section 78y, and the *Thunder Basin* factors, the 9-7 majority held that Congress did not strip district courts of their jurisdiction to hear structural constitutional claims such as Cochran's.<sup>7</sup>

The Fifth Circuit, in an opinion authored by Judge Haynes, held that the text of section 78y — under which a “person aggrieved by a final order of the [SEC] . . . may obtain review of the order in” certain circuit courts of appeals — neither explicitly nor implicitly strips district courts from hearing structural constitutional claims where the SEC has not issued a final order. First, although section 78y specifies that persons aggrieved by a *final* SEC order may petition the relevant courts of appeals, it “says nothing about people, like Cochran, who have not yet received a final order.” *Id.* at 200. And because Cochran’s claim was wholly unrelated to the conduct for which she was prosecuted, it has “nothing to do with any final order that the [SEC] might one day issue.” *Id.* Second, although section 78y(a)(1) is phrased permissively by using the word “may” — “it does not say that anyone ‘shall’ or ‘shall not’ do anything,” *id.* at 201 — section 78y elsewhere uses mandatory language. For example, section 78y(a)(3) provides that jurisdiction “becomes exclusive” in the court of appeals only after (1) the SEC issues a final order, (2) an aggrieved party files a petition, and (3) the SEC submits its administrative record. “The use of the word ‘exclusive’ in § 78y(a)(3) shows that Congress knew how to strip jurisdiction when it wanted to—and it only highlights that Congress did not strip § 1331 jurisdiction elsewhere.” *Id.* at 201.

According to the *en banc* Fifth Circuit, the Supreme Court’s decision in *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010), further compels the conclusion that section 78y does not strip federal district courts of their power to hear structural constitutional claims. In *Free Enterprise Fund*, the PCAOB opened a formal investigation into an accounting firm’s practices and the accounting firm sued in federal district court, seeking injunctive relief and alleging that the PCAOB was unconstitutionally structured due to dual for-cause limitations on the removal of Board members. 561 U.S. at 487. In response, the government argued that section 78y deprived the district court of subject matter jurisdiction and moved to dismiss. *Id.* at 489. The Supreme Court rejected the government’s argument, and, applying the *Thunder Basin* factors,<sup>8</sup> held that “the text [of section 78y] does not expressly limit [district court] jurisdiction .... Nor does it do so implicitly.” *Id.* According to the *Cochran* majority, “every material aspect of the Supreme Court’s reasoning in *Free Enterprise Fund* would seem to apply” to Cochran’s challenge, and the fact that an enforcement proceeding already had been commenced against Cochran was insufficient to distinguish the Supreme Court’s interpretation of section 78y in the context of a removal power claim. *Cochran*, 20 F.4th at 203.

Conducting its own application of the *Thunder Basin* factors, the *en banc* Fifth Circuit found that each factor weighed in favor of permitting Cochran’s removal power claim to proceed before the district court: (1) section 78y did not afford Cochran meaningful review of her claim because the enforcement proceedings would not necessarily result in an adverse order (a prerequisite for judicial review under section 78y(a)(1)); (2) Cochran’s claim was wholly collateral to the Exchange Act’s statutory-review scheme; and (3) constitutional removal power claims are outside the SEC’s area of expertise. *Id.* at 206-10. “[T]he *Thunder Basin* inquiry simply reaffirms that *Free Enterprise Fund* controls this case and that Cochran’s removal power claim is within the district court’s jurisdiction.” *Id.* at 212 (reversing the district court’s dismissal of Cochran’s removal power claim and remanding for further proceedings).

Seven judges dissented. In dissent, Judge Costa, author of the reversed panel opinion and joined by each of the dissenting judges, emphasized that the majority, “for the first time in the 80-plus year history of the SEC,” permitted a person facing SEC enforcement to bring a simultaneous proceeding against the agency in federal district

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<sup>7</sup> The majority also rejected the SEC’s argument that Cochran’s removal power claim was not ripe, finding that it involved a pure issue of law that could be decided without any additional fact-finding and that withholding court consideration would impose a hardship. *Cochran*, 20 F.4th at 212-13.

<sup>8</sup> *Supra* n. 5.

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court. *Id.* at 236 (Costa, J., dissenting). The dissent criticized the consequences following from the majority's ruling. First, according to the dissent, the ruling may create duplicative proceedings, as the majority's decision "multiplies the number of court proceedings arising out of an SEC enforcement action and allows the anomaly of different courts of appeals' reviewing the same agency proceeding." *Id.* Second, the dissent wrote that, by making structural constitutional claims "a first rather than last resort in resolving cases," the majority "turns constitutional avoidance on its head." *Id.*

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### III. Implications

By ruling that section 78y does not strip federal district courts of their jurisdiction to hear structural constitutional challenges to ongoing SEC proceedings, the Fifth Circuit has created a circuit split, departing from the prevailing view of the circuit courts of appeals for the Second, Fourth, Seventh, Eleventh, and D.C. Circuits.<sup>9</sup> The SEC has 90 days to file a writ of *certiorari*, and the Supreme Court may decide to hear the case to resolve the circuit split. The petitioner in an unrelated case involving the Federal Trade Commission ("FTC") Act, *Axon Enterprise, Inc. v. FTC*, No. 21-86 (U.S.), already has filed a writ of *certiorari*, arguing that the circuit split created by *Cochran* "on the critically important question of whether district courts may hear constitutional challenges to an agency's structure or existence," compels a grant of *certiorari* in its action. Supplemental Brief for Petitioner at 1, *Axon Enterprise, Inc. v. FTC* (U.S. Dec. 20, 2021) (No. 21-86).<sup>10</sup>

The Fifth Circuit's decision in *Cochran* opens the door for respondents in SEC administrative proceedings in the Fifth Circuit (and other circuits that have not decided this issue) to wage immediate collateral challenges in a district court, rather than being forced to wait for a decision by an Administrative Law Judge. The decision could result in more and different constitutional challenges in district courts in those circuits. Until the circuit split is resolved, the SEC might opt to avoid administrative proceedings against some respondents within those jurisdictions by filing enforcement proceedings in district court.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Bradley J. Bondi (Partner) at 202.862.8910 or [bbondi@cahill.com](mailto:bbondi@cahill.com); Joel Kurtzberg (Partner) at 212.701.3120 or [jkurtzberg@cahill.com](mailto:jkurtzberg@cahill.com); Miles Wiley (Associate) at 212.701.3395 or [mwiley@cahill.com](mailto:mwiley@cahill.com); or Jason Rozbruch (Associate) at 212.701.3750 or [jrozbruch@cahill.com](mailto:jrozbruch@cahill.com); or email [publications@cahill.com](mailto:publications@cahill.com).

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<sup>9</sup> See *supra* n. 1.

<sup>10</sup> The Petitioners in *Axon* seek review of a Ninth Circuit decision holding that the district court lacked subject matter jurisdiction over *Axon Enterprise's* action challenging the FTC's administrative enforcement process as unconstitutional. *Axon Enterprise, Inc. v. FTC*, 986 F.3d 1173, 1176 (9th Cir. 2021). The Ninth Circuit held that structure of the FTC Act "suggests that Congress impliedly barred jurisdiction in district court and required parties to move forward first in the agency proceeding." *Id.* at 1177.

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