No. 20-61007

**UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

GEORGE R. JARKESY, JR.; PATRIOT28, L.L.C.,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review from the Securities and Exchange Commission, Admin. Proc. File No. 3-15255

***AMICUS CURIAE* BRIEF FOR THE CATO INSTITUTE IN SUPPORT OF PETITIONERS**

Ilya Shapiro
Jennifer J. Schulp
CATO INSTITUTE
1000 Mass. Ave. NW
Washington, DC 20001
(202) 842-0200
ishapiro@cato.org

Russell G. Ryan
Ashley C. Parrish
Gabriel Krimm
KING & SPALDING LLP
1700 Pennsylvania Avenue NW
Washington, DC 20006
(202) 797-0500
RRyan@kslaw.com

I. Cason Hewgley IV
KING & SPALDING LLP
1100 Louisiana Street, Ste. 4100
Houston, TX 77002

March 17, 2021

Counsel for Amicus Curiae

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record for *amicus curiae* certifies that the following listed persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1, in addition to those listed in the Petitioners' Certificate of Interested Persons, have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

Amicus Curiae: The Cato Institute is a not-for-profit corporation exempt from income tax under section 501(c)(3) of the Internal Revenue Code, 26 U.S.C. § 501(c)(3). It does not have a parent corporation and no publicly held company has a 10% or greater ownership interest.

Counsel for Amicus: Russell G. Ryan; Ashley C. Parrish; I. Cason Hewgley, IV; and Gabriel Krimm, all of King & Spalding LLP; Ilya Shapiro and Jennifer J. Schulp of the Cato Institute.

Dated: March 17, 2021

/s/ Russell G. Ryan

Russell G. Ryan
KING & SPALDING LLP
1700 Pennsylvania Avenue NW
Washington, DC 20006
(202) 797-0500
RRyan@kslaw.com

Counsel for Amicus Curiae

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutional Provisions

Statutes, Regulations, & Rule

Other Authorities

INTEREST OF *AMICUS CURIAE*

The Cato Institute was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies was established in 1989 to promote the principles of limited constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences, issues the annual *Cato Supreme Court Review*, and files *amicus* briefs with the courts.

This case interests Cato because the separation of powers is one of the key ways in which our system of government protects individual liberty and property, the deprivation of which through unaccountable administrative processes raises serious constitutional issues.

The parties have consented to the filing of this *amicus* brief. No party or counsel for a party authored this brief in whole or in part. No party, counsel for a party, or person other than amicus, its members, or counsel made any monetary contribution intended to fund the preparation or submission of this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

Whatever the merits of this enforcement action, petitioner George Jarkesy has been deprived of his liberty and property without due process of law. The administrative procedures used by the Securities and Exchange Commission improperly allow the Commission to serve simultaneously as lawmaker, detective, accuser, prosecutor, jury, and judge. They offer defendants like Jarkesy little opportunity to prepare or be meaningfully heard. And the entire process is, by design, drenched in institutional partiality. This Court should set it straight.

The events underlying this enforcement action began nearly 15 years ago, just before the 2008 financial crisis. In early 2007, Jarkesy founded John Thomas Capital Management Group, LLC with the intent of managing several "hedge" investment funds. Those funds were geared toward sophisticated parties interested in high-risk, high-reward investments. Promising to pursue such investment opportunities, Jarkesy raised approximately $24 million from over 100 investors. Unfortunately, some of the venture's early investments did not pan out, and the funds suffered losses.

Jarkesy's hedge-fund businesses did not fall under the licensing authority of the SEC. He is not (and never was) a registered broker-dealer or investment adviser, he has never enjoyed special legal privileges under the securities laws, and he did not need the Commission's permission to open or manage his hedge funds. Instead, at all times relevant to this case, Jarkesy was a private business owner entitled to all of the rights and privileges of any other private person.

Nevertheless, following the hedge funds' losses and a political push to crack down on the financial industry, the SEC prosecuted Jarkesy by summary administrative process under the Dodd-Frank Wall Street Reform Act of 2010. After years of nonpublic investigation into Jarkesy and his businesses, the Commission's enforcement staff gave a privileged, *ex parte* presentation to the SEC commissioners describing the nature of Jarkesy's alleged misconduct and the laws allegedly violated. The commissioners relied on that presentation to initiate a public administrative enforcement action in March 2013, and on the same day gratuitously issued an official press release touting the merits of the agency's case. Then, following prehearing procedures promulgated by the SEC that hamper development of a robust defense, Jarkesy was tried before an Administrative Law Judge ("ALJ") appointed by and reporting to the Commission. Unsurprisingly, the ALJ made credibility determinations and factual findings in the Commission's favor. The commissioners then affirmed those findings on intra-agency appeal while modestly reducing the financial sanctions. Now, in its final step, the Commission urges this Court to bless its one-sided process by applying the deferential judicial-review standards of the Administrative Procedure Act.

This system is not consistent with our constitutional order, and it yields predictably biased and unfair results. The Constitution separates government powers and guarantees fair and impartial adjudication procedures to prevent arbitrary deprivations of life, liberty, and property. Although our legal traditions allow limited easing of those requirements in a narrow set of cases that do not involve vested private rights, this is not one of those cases. Nevertheless, the SEC has come to believe that stripping a citizen of liberty and property by expedient executive-branch adjudication is acceptable. It is not, and the failure to recognize that fact has in recent years borne an administrative enforcement machinery imbued with an unacceptable risk and appearance of institutional partiality.

The SEC's prosecution of Jarkesy crossed the line. His petition should be granted, the Commission's order vacated, and this case remanded with instructions that the Commission start over in a manner consistent with the Constitution.

ARGUMENT

I. The Constitution Requires Separation of Government Powers and Protections for the Accused.

The adjudicative powers of the Executive Branch are necessarily limited. *See Oil States Energy Servs., LLC v. Greene's Energy Grp., LLC*, 138 S. Ct. 1365, 1373 (2018). In the mine-run of cases, the Constitution's due process guarantee requires the government to bring quasi-criminal, accusatory lawsuits against private persons in the Article III courts, subject to impartial adjudication by independent judges and lay juries. *See Stern v. Marshall*, 564 U.S. 462, 482–83 (2011). Administrative adjudications are an exception to that rule, available when a suit concerns public rights and privileges, not the vested liberty and property rights of private citizens. *See Exec. Benefits Ins. Agency v. Arkison*, 573

U.S. 25, 32–33 (2014); *see also* Caleb Nelson, *Adjudication in the Political Branches*, 107 Colum. L. Rev. 559, 563 (2007).

This bedrock principle has been recognized since the founding. Indeed, the Framers separated and blended the United States' sovereign powers to create a potent government that simultaneously protected individual rights. *See Perez v. Mortg. Bankers Ass'n,* 575 U.S. 92, 116–19 (2015) (Thomas, J., concurring); *see also* William Bradford Reynolds, *Originalism and the Separation of Powers*, 63 Tul. L. Rev. 1541, 1550–51 & n.31 (1989) ("The framers … had a deep and distrustful vision of … the corrupting effects of unchecked power …."). They achieved that end by two profound steps: *First*, they vested the political powers—legislative and executive—in two representative branches, *see* U.S. Const. art. I, § 1; *id.* art. II, § 1, cl. 1, while entrusting the judicial power to a separate, independent branch, *see id.* art. III, § 1; *see also* The Federalist Nos. 78, 79 (Alexander Hamilton). *Second*, they incorporated individualized safeguards for those accused of wrongdoing. Among these were the ancient common law rights to due process and trial by jury. U.S. Const. art. III, § 2, cl. 3; *id.* amends. IV–VII.

When combined, these features ensure that no person is deprived of rights in life, liberty, or property without a broad political and legal consensus: "a law permitting such [a] deprivation[], an executive deci[sion] to enforce that law, and a court adjudicat[ion of] the facts" in front of an impartial judge and lay jury. Ilan Wurman, *Constitutional Administration*, 69 Stan. L. Rev. 359, 370 (2017). Building that consensus is difficult—but that's the point. "[T]he Framers weighed the need for federal government efficiency against the potential for abuse and came out heavily in favor of limiting federal government power." Rachel E. Barkow, *Separation of Powers and the Criminal Law*, 58 Stan. L. Rev. 989, 1017 (2006).

In the ensuing two centuries, the political branches have often pushed for more expedient arrangements. As the Framers expected, temporary "ill humors" sometimes "occasion … innovations in the government" that cut against traditional checks and balances. The Federalist No. 78 (Alexander Hamilton); *see* Steven G. Calabresi & Gary Lawson, *The Depravity of the 1930s and the Modern Administrative State*, 94 Notre Dame L. Rev. 821, 829–30 (2018). And the right to a full adjudicative process in an independent forum has, in certain instances, been weakened or eliminated. *See* Gary Lawson, *The Rise and Rise of the Administrative State*, 107 Harv. L. Rev. 1231, 1246–48 (1994).

There is nothing *necessarily* wrong with this. Our legal traditions have always allowed executive-branch adjudications—to *some* extent. *See Oil States,* 138 S. Ct. at 1373. Indeed, a person's *procedural* right to an Article III tribunal (and all its attendant constitutional protections) has always turned on what *substantive* interests hung in the balance. On one hand, there are "private right[s]," which must be adjudicated in "the common law, … equity, or admiralty" courts. *Den ex rel. Murray v. Hoboken Land & Improvement Co.* (*Murray's Lessee*), 59 U.S. (18 How.) 272, 284–85 (1856). On the other hand, there are private *privileges* tied to "public rights," for which something less than Article III process is required. *Id.*; *see also Oil States*, 138 S. Ct. at 1373 (noting that Congress has "significant latitude to assign adjudication of public rights to entities other than Article III courts"); *see generally* William Baude, *Adjudication Outside Article III*, 133 Harv. L. Rev. 1511, 1536 (2020) ("[T]he so-called 'public rights' doctrine really describes a set of adjudications that are permissible because they are a form of executive power and usually do not involve deprivations of life, liberty, or property.").

How can courts distinguish the two? As traditionally understood, the "private rights" label encompasses interests in life, liberty, and property that have fully vested in private persons and are thus protected by the common law. *See* Nelson, 107 Colum. L. Rev. at 565–67. "Public rights," by contrast, are "the ownership interests of the government," which it may tentatively confer on private persons as privileges or benefits. John Harrison, *Public Rights, Private Privileges, and Article III*, 54 Ga. L. Rev. 143, 163–64 (2019); *see id.* at 166–70; Nelson, 107 Colum. L. Rev. at 567–68. Such privileges and benefits, which include licenses, patents, and other government largess, can be kept from fully vesting in private hands (and thus becoming private rights) by the government's imposition of special encumbrances and conditions. *Oil States*, 138 S. Ct. at 1373; *see* Nelson, 107 Colum. L. Rev. at 583; Harrison, 54 Ga. L. Rev. at 170.

One species of conditions is assent to adjudication in an executive-branch tribunal. *See Oil States*, 138 S. Ct. at 1374–75; *see* Harrison, 54 Ga. L. Rev. at 179. When legitimately imposed, this requirement can establish an administrative agency as the sole adjudicator of a privilege or public right due to the government's sovereign immunity from compulsory process in the Article III courts. *See Murray's Lessee*, 59 U.S. (18 How.) at 284; *see also* Caleb Nelson, *Sovereign Immunity as a Doctrine of Personal Jurisdiction*, 115 Harv. L. Rev. 1559, 1573–78 (2002) (explaining the principle of sovereign immunity). Such an arrangement is constitutional precisely because the executive-branch adjudication does *not* extend to deprivations of vested private rights. Instead, it concerns only those interests that the government, on behalf of the public, can distribute and withdraw at will. *See* Baude, 133 Harv. L. Rev. at 1536.

As the administrative state has expanded, the Supreme Court has sometimes loosened the "public rights" exception's narrow boundaries, and precedent has "not been entirely consistent." *Oil States*, 138 S. Ct. at 1373 (quoting *Stern*, 564 U.S. at 488). In some contexts, for example, the Court has allowed private rights *affiliated* with certain regulatory schemes to be adjudicated (at least initially) outside of the Article III courts. *See Crowell v. Benson*, 285 U.S. 22, 51–65 (1932). In others, the Court has expanded the concept of "public rights" to sweep in traditionally private rights impacted by certain regulatory regimes. *See Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 589–90 (1985);

Atlas Roofing Co. v. OSHRC, 430 U.S. 442, 450–56 (1977). These precedents have been subject to controversy and criticism. *See, e.g.*, Kent Barnett, *Due Process for Article III—Rethinking* Murray's Lessee, 26 Geo. Mason L. Rev. 677, 681–92 (2019) (describing the "public-rights exception" as a "doctrinal and theoretical mess," *id.* at 692).

In this case, however, none of those precedents control. Indeed, the SEC's defense of its post-Dodd Frank administrative adjudication process must necessarily urge this Court to go far beyond what the Supreme Court has ever permitted. *See* Ryan Jones, *The Fight Over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. Rev. 507, 516 (2015) (explaining the expansion of SEC adjudication authority through Dodd-Frank in 2010); *see also Jarkesy v. SEC*, 803 F.3d 9, 12–13, 30 (D.C. Cir. 2015) (declining to address the constitutional issues in a collateral APA action). And because the Court has recently reaffirmed the traditional dichotomy between public rights and private rights and signaled a renewed commitment to maintaining it*, see Oil States*, 138 S. Ct. at 1372–73; *see also id.* at 1380–86 (Gorsuch, J., dissenting), this Court should apply that framework in evaluating what process is due given the core private liberty and property rights at stake in this case.

II. The SEC's New Powers Exceed the Lawful Limits of Administrative Adjudication.

This enforcement action marks the culmination of a decades-long creep of agency power that now pushes or exceeds nearly every due-process boundary imaginable. When Congress first established the SEC in the mid-1930s, it respected the separation of powers and the rights of the accused. The original Securities Exchange Act of 1934 empowered the Commission to enforce violations of the new securities laws primarily by "seeking injunctions in federal district court." Thomas Glassman, *Ice Skating Up Hill: Constitutional Challenges to SEC Administrative Proceedings*, 16 J. Bus. & Sec. L. 47, 50 (2015). Administrative proceedings, by contrast, could be used only to "expel members or officers of [the] national securities exchanges" that the Act directly regulated. *Id.*

Even as SEC powers and duties expanded over the next several decades, a defendant's right to process in an Article III court was largely preserved. Each time the Commission "obtained or asserted additional administrative powers … the expansion was tied to the agency's oversight of regulated entities or those representing those entities before the Commission, and even then was largely ancillary to the broader remedies and sanctions [the Commission] could obtain" in court. *Id.* (quoting Jed S. Rakoff, U.S. Dist. Judge, S.D.N.Y., Keynote Address at the PLI Securities Regulation Institute: Is the S.E.C. Becoming a Law Unto Itself? (Nov. 5, 2014), https://perma.cc/5N8A-TNYN). Indeed, the Commission's adjudicative purview largely remained limited to cases involving the registration and deregistration of securities, *see* 15 U.S.C. §§ 77h(d), 78*l*(j), and the barring or suspension of SEC-licensed securities firms and their associated persons, *see id.* §§ 78*o*(b)(4), 80a-8(e), 80a-9(b), 80b-3(c)(2)(b), 80b-3(e), 80b-3(f).

Given these limited administrative powers and the fact that SEC-regulated respondents had arguably "consented" to such procedures, Stephen J. Choi & A. C. Pritchard, *The SEC's Shift to Administrative Proceedings: An Empirical Assessment*, 34 Yale J. on Reg. 1, 6 (2017), the system remained largely consistent with the traditional boundaries of agency adjudication. Where the government giveth, it can also taketh—even in a non-Article III adjudication, *Oil States*, 138 S. Ct. at 1374–75, and often with relaxed procedural guarantees, *see Steadman v. SEC*, 450

U.S. 91, 102 (1981) (affirming SEC authority to strip license based on proof of a violation by a mere preponderance of the evidence).

Over the past four decades, however, Congress and the SEC have seized on crisis and scandal to push constitutional boundaries. In the 1980s, concerns over insider trading led to an expansion of the remedies the Commission could obtain from courts as punishment for violating the law. *See* Glassman, 16 J. Bus. & Sec. L. at 51; Jones, 68 SMU L. Rev. at 511. And with enactment of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the "Remedies Act"), the Commission's administrative adjudications could for the first time result in money penalties against SEC-regulated parties and permanent cease-and-desist orders against even *non-regulated* parties. Pub. L. No. 101-429, §§ 202(a), 301, 401, 104 Stat. 931, 937, 941–45, 946–49 (1990) (codified respectively at 15 U.S.C §§ 78u-2, 80a-9(d), and 80b-3(i)); *see* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 Fordham J. Corp. & Fin. L. 367, 392–93 (2008); Jones, 68 SMU L. Rev. at 511–12; *see* Choi, 34 Yale J. on Reg. at 7. In this same time frame, the Commission set out to increase "efficiency" in its adjudicative process by truncating and streamlining discovery and trial procedures. Jones, 68 SMU L. Rev.at 513. Still, throughout the 1990s and early 2000s, if the Commission wished to impose penalties on unregistered private citizens, or otherwise to materially deprive them of their private rights to liberty or property, it had to prove its case in an Article III court. *See* Remedies Act §§ 101, 201, 302, 402 (codified at 15 U.S.C. §§ 77t(d), 78u(d)(3); 80a-41(e), and 80b-9(e)).

In the wake of the 2008 financial crisis, however, Congress took an unprecedented leap. In the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, it purported to empower the SEC to impose harsh quasi-criminal sanctions against *any* private citizen through its own administrative adjudications with only limited, after-the-fact review by a federal court of appeals. *See* Pub. Law No. 111-203, § 929P, 124 Stat. 1376, 1862–64 (2010) (codified at 15 U.S.C. §§ 77h-1(g), 78u-2(a)(2), 80a-9(d), and 80b-3(i)); *see also* Choi, 34 Yale J. on Reg. at 9 (explaining this development). The Commission had sought this extraordinary power decades earlier, but Congress had declined to grant it "specifically 'because the [Commission] might be perceived to have an incentive to conduct more enforcement actions through its own administrative proceedings.'" Jones, 68 SMU L. Rev. at 516 (quoting Atkins, 13 Fordham J. Corp. & Fin. L. at 393–94). Through Dodd-Frank, Congress threw that caution to the wind.

The results were predictable. Rather than exercise its novel authority to avoid or at least minimize serious separation-of-powers and due process concerns, the SEC has exacerbated them. *See* Section III, *infra*. This case is a perfect example: Jarkesy is a private citizen, not a government licensee or even a registered securities professional. He acquired his money in private commerce, not from the public fisc. He has never consented to adjudication before an administrative tribunal. Yet the Commission seeks to deprive him of more than $1,000,000 of personal property and the freedom to participate in the securities industry or to serve as an officer or director of a publicly listed company. And to accomplish this result, the SEC chose *not* to try Jarkesy before an independent court or a council of his peers. Instead, the Commission—a single cadre of unaccountable administrators—opted to investigate, charge, adjudge, and punish Jarkesy all on its own.

III. Allowing the Commission to Adjudicate Its Own Prosecutions Risks Institutional Bias and Lopsided Results.

The constitutionally suspect structure of SEC in-house adjudications creates the inherent risk and appearance of institutional bias, and it yields predictably unfair results. *See Clinton v. City of New York*, 524 U.S. 417, 450 (1998) (Kennedy, J., concurring) ("Liberty is always at stake when one or more of the branches seek to transgress the separation of powers."). Chief among the liberties secured by the Constitution is the right to a "[a] fair trial in a fair tribunal," *In re Murchison*, 349 U.S. 133, 136 (1955), "one of the rudiments of fair play assured to every litigant," and an "inexorable safeguard" of individual liberty. *Ohio Bell Tel. Co. v. Pub. Utils. Comm'n of Ohio*, 301 U.S. 292, 304–05 (1937) (internal quotation marks and citation omitted). Flouting these norms, the SEC relies on an administrative process infected with structural bias, and it routinely convicts private citizens like Jarkesy with only a shadow of due process.

A fair trial requires an adjudicator who lacks "a direct, personal, substantial, pecuniary interest" in a case. *Tumey v. Ohio*, 273 U.S. 510, 523 (1927); *see also* The Federalist No. 10 (James Madison) ("No man is allowed to be a judge in his own cause; because his interest would certainly bias his judgment, and, not improbably, corrupt his integrity."). Also forbidden is the "objective risk of actual bias," regardless of "whether or not actual bias exists or can be proved." *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 886 (2009); *accord Williams v. Pennsylvania*, 136 S. Ct. 1899, 1905 (2016) (courts "apply an objective standard" that asks not whether the adjudicator harbors actual, subjective bias, but instead whether, as an objective matter, "there is an unconstitutional 'potential for bias'" (quoting *Caperton*, 556 U.S. at 881)). Due process is violated where perceived bias, "under all the circumstances 'would offer a possible temptation to the average … judge to … lead him not to hold the balance nice, clear[,] and true.'" *Caperton*, 556 U.S. at 885 (quoting *Tumey*, 273 U.S. at 532).

On their face and as applied in this case, SEC administrative enforcement proceedings are rife with institutional biases that create a constitutionally intolerable risk and perception that those accused will not get a fair shake. To start, the Commission is quite literally on the same side as the prosecutors: The Commission's own Division of Enforcement, which is primarily composed of attorneys who simultaneously advise the Commissioners as trusted fiduciary counsel and who represent the Commission as litigation counsel in other cases in federal court.

Regardless of the "separation of function" rules to which the SEC and its staff ostensibly adhere, *see* 5 U.S.C. § 554(d) & 17 C.F.R. § 201.101(a), the Commission is, in every meaningful sense, adjudicating its own case—a well-established violation of due process. *See In re Murchison*, 349 U.S. at 136 ("[N]o man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome."). In such circumstances, some measure of institutional bias is unavoidable. *See* Philip Hamburger, Is Administrative Law Unlawful? 337–38 (2014) ("Like employees of the old prerogative bodies, employees of administrative bodies become psychologically attached to the sort power of in which they play a role, and they therefore are in no position to judge the lawfulness of any exercise of that power."). And indeed, this "combination of investigative and adjudicative functions" violates due process where "from the special facts and circumstances … the risk of unfairness is intolerably high." *Withrow v. Larkin*, 421 U.S. 35, 58 (1975).

This functional cross-pollination within the SEC is apparent from the get-go, when *the Commission* decides whether to institute an enforcement action (for which it then becomes the ultimate adjudicator). *See* 17 C.F.R. §§ 201.101(a), (4), (7) and 201.200. It typically makes this determination after the agency's Enforcement Division prosecutors have presented their case to the Commissioners in written and oral *ex parte* communications cloaked by attorney-client privilege. *See* SEC Enforcement Manual § 2.5 (last updated Nov. 28, 2017); *see also Sierra Club v. Costle,* 657 F.2d 298, 400 (D.C. Cir. 1981), *as amended* (June 1, 1981) ("[T]he insulation of the decisionmaker from ex parte contacts is justified by basic notions of due process to the parties involved."); *cf. Withrow*, 421 U.S. at 40, 55 (finding significant that during the nonpublic investigative hearing that led to the public adjudicative proceeding on review, "[respondent] and his counsel were permitted to be present throughout; counsel actually attended the hearings, and knew the facts presented to the Board"). Although the accused is typically allowed to submit a written position statement (commonly referred to as a "Wells submission") before the SEC decides whether to file charges, *see* 17 C.F.R. § 202.5(c), the Commission's prosecution team can refute that statement in its *ex parte* communications with the commissioners, whereas the accused neither sees the prosecutors' written presentation nor hears the contents of their (privileged) discussions with the commissioners.

Thus, by the time the Commission *initiates* its public adjudicatory proceeding, it has already weighed the evidence and made a threshold determination that the case has enough merit to justify public charges and a public hearing, which is more than enough to undermine "the very appearance of complete fairness." *Amos Treat & Co. v. SEC*, 306 F.2d 260, 267 (D.C. Cir. 1962) ("We are unable to accept the view that a member of an investigative or prosecuting staff may … recommend the filing of charges, and thereafter … participate in adjudicatory proceedings"); *accord Williams*, 136 S. Ct. at 1907–08 (due process violated in civil post-conviction case where state supreme court justice, as a former district attorney, had approved subordinate prosecutor's request to seek death penalty in underlying criminal case 25 years earlier).

In some cases, including Jarkesy's, *the Commission* will then even issue an official press release that reads as if the case has already been proved, the facts found, and the respondent deemed guilty. *See* SEC, Press Release No. 2013-46, SEC Charges Hedge Fund Manager and Brokerage CEO With Fraud (Mar. 22, 2013), https://www.sec.gov/news/

press-release/2013-2013-46htm. These SEC press releases typically blur the line between the Enforcement Division's mere allegations and the Commission's purported neutrality as the ultimate adjudicator. Reviewing these accusatory press releases, "a disinterested reader … could hardly fail to conclude" that the Commission has "in some measure decided in advance" that the accused has violated the law. *Texaco, Inc. v. FTC*, 336 F.2d 754, 760 (D.C. Cir. 1964), *vacated on unrelated grounds*, 381 U.S. 739 (1965) (per curiam)). Such prejudgment violates due process. *See Antoniu v. SEC*, 877 F.2d 721, 725 (8th Cir. 1989) (SEC Commissioner's speech about pending case created impermissible bias); *Am. Cyanamid Co. v. FTC*, 363 F.2d 757 (6th Cir. 1966) (disqualifying commissioner who had, in a former role, investigated many of the same facts at issue).

From the very start of the adjudicative proceeding, then, those accused are publicly labelled wrongdoers unless and until they prove otherwise. But the deck is then further stacked against them with lopsided procedural rules promulgated by *the Commission*. Forced to prepare their defenses within strict timelines—a *maximum* of ten months in the most complex of cases, *see* 17 C.F.R. § 201.360(a)(2)(C)(ii)—

respondents are immediately on the back foot. And yet, while scrambling to catch up, respondents have few tools at their disposal—only in the most complex SEC administrative cases are they allowed depositions at all, and even these are subject to strict limits. *Compare* 17 C.F.R. § 201.233(a)(1) (maximum of three depositions per side in single-respondent cases and five per side in multi-respondent cases), *with* Fed. R. Civ. P. 30 (permitting 10 depositions and more with leave). In contrast, the Commission's prosecution team has typically already taken plenty of time to investigate and prepare its case; the average SEC investigation takes more than two years, *see* SEC, Division of Enforcement 2020 Annual Report, at 6 (2020), and many take five years or more. And the prosecutors have typically enjoyed subpoena power throughout their investigation, often amassing substantial evidence through document productions and sworn nonpublic testimony. *See, e.g.*, 15 U.S.C. §§ 78u(b), 80b-9(b); 6 Thomas Lee Hazen, Law Sec. Reg. § 16:101 (2020).

The specter of bias and prejudgment shows its face again where, as here, co-respondents choose to settle rather than press their luck in a stacked proceeding. When this occurs, the Commission typically issues a public settlement order with gratuitously detailed "findings" of misconduct (to which the settling party has agreed without admitting or denying). Here, that order incriminated not just the settling respondents but Jarkesy and his company, who were superficially anonymized as "the Manager" and "the Adviser," but whose identities were obvious. *See John Thomas Capital Mgmt. Grp., LLC,* Exchange Act Release No. 34-70989, at 2 (Dec. 5, 2013). The Commission brushed off Jarkesy's claim that these "findings" prejudged the facts against him, pointing to language in a boilerplate footnote stating that the findings were not "binding" on any other person. *Id.* at 2 n.1. But Jarkesy might reasonably be forgiven for believing that this footnote did not entirely erase the public "findings" or sanitize this arrangement, where the Commission might naturally be reluctant to contradict its "non-binding" findings later when it adjudicated essentially the same facts all over again.

SEC administrative proceedings then substitute trial before a petit jury—the constitutional gold standard for adjudicating private rights, *see Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989)—with an initial hearing before an ALJ who, like the prosecutors, reports to *the Commission*. *See* SEC Organization Chart (2020), https://www.sec.gov/about/secorg.pdf. That is not a fair trade and provides little comfort for the accused. ALJs act according to authority delegated by the Commission, 15 U.S.C. § 78d-1(a); 17 C.F.R. § 200.30-10, and their positions are created, maintained, and funded by the Commission. The tenure protection ostensibly enjoyed by ALJs might well be unconstitutional, *see Lucia v. SEC*, 138 S. Ct. 2044 (2018) (holding the Commission's ALJs are inferior officers); *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 492, 496 (2010) (holding unconstitutional two-layer tenure protection of inferior officers), and is likely not worth its salt anyway, *see SSA v. Goodman*, 19 M.S.P.R. 321, 326 (1984) (suggesting that ALJs can be removed for "insubordination").

Anecdotal evidence suggests that Commission ALJs may, in fact, feel pressured to find for the agency. *See* Jean Eaglesham, *SEC Wins With In-House Judges*, Wall St. J. (May 6, 2015), http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803 (former ALJ stating that she "came under fire … for finding too often in favor of defendants"); Charles H. Koch, Jr., *Administrative Presiding Officials Today*, 46 Admin. L. Rev. 271, 278–79 (1994) (34% of non-Social Security ALJs were "asked to do things that are against their better judgment," 15% believe "threats to independence were a problem," and 9% were "pressure[d] to make different decisions"). *But see* Urska Velikonja, *Are the SEC's Administrative Law Judges Biased? An Empirical Investigation*, 92 Wash. L. Rev. 315, 340, 362–68 (2017) (challenging evidence of ALJ bias). Regardless of whether actual bias exists, there is at best a serious risk and appearance of a biased proceeding—an unacceptable risk in this quasi-criminal context. *See* Hamburger, *supra*, at 231 ("[W]here agencies adjudicate cases of a criminal nature, they tend to deny the associated constitutional rights.").

An ALJ's initial decision is appealable to the Commission, but this too is cold comfort. Naturally, the Commission rarely rules against itself. From 2010 to 2015, the Commissioners decided 95% of appeals in the agency's favor, sometimes overruling ALJ decisions that were more favorable to the respondent and sometimes imposing harsher sanctions. Eaglesham, *SEC Wins with In-House Judges*, *supra*. This is predictable; after all, the Commission describes itself as "first and foremost a law enforcement agency," and has pledged to be "bold and unrelenting" in pursuit of securities violators. *See* Christopher Cox, Chair, SEC, Address at the PLI 40th Annual Securities Regulation Institute: Building on Strengths in Designing the New Regulatory Structure (Nov. 12, 2008), https://www.sec.gov/news/speech/2008/spch111208cc.htm; *Nominations Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 113th Cong. 10 (2013) (statement of Chair Mary Jo White).

The SEC's financial and political interests also provide strong temptation to rule against respondents. Although the Commission does not directly profit from the monetary awards it imposes, recovered funds are either distributed to harmed investors under the Fair Funds for Investors provision of Sarbanes-Oxley, *see* 15 U.S.C. § 7246, or deposited into a fund that pays whistleblowers under a provision of Dodd-Frank, *see* 15 U.S.C. § 78u-6. The Commission frequently boasts about these efforts, *see, e.g.*, SEC, Press Release No. 2021-44, SEC Awards Approximately $1.5 Million to Whistleblower (Mar. 9, 2021), https://www.sec.gov/news/press-release/2021-44 (Commission "has awarded approximately $759 million to 143 individuals" since 2012); SEC, Selected Division of Enforcement Accomplishments: December 2016 – December 2020 (last modified Dec. 30, 2020), www.sec.gov/enforce/selected-division-enforcement-accomplishments-december-2016-december-2020 (Commission has "returned approximately $3.6 billion to harmed investors" since 2016), and is lavishly praised for them by the media, advocacy groups, and (most crucially) the politicians who ultimately determine the agency's budget, *see* Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 Harv. J. L. & Pub. Pol'y 639, 643–46 (2010) ("It certainly appears that the SEC is carrying out its (enforcement) duties so as to maintain a base of support within the Congressional budget process." (internal quotation marks omitted)). With its mission and funding at stake, it's not hard to fathom the Commission's incentives to win cases and pad its numbers. *Cf. Ward v. Vill. of Monroeville*, 409 U.S. 57, 60 (1972) ("[T]he mayor's executive responsibilities for village finances may make him partisan to maintain the high level of contribution from [fines imposed by] the mayor's court.").

The SEC also has strong jurisprudential temptations to rule in favor of its Enforcement Division prosecutors whenever possible. By doing so, the Commission can often steer the development of securities law in its favor, establishing a body of self-serving "precedent" it can then use to its advantage when litigating subsequent cases in federal courts—where, as noted above, the same Enforcement Division prosecutors represent the agency as its counsel—or when extracting settlements. *See*

Rakoff, Is the S.E.C. Becoming a Law Unto Itself?, *supra* (expressing concern about SEC using administrative adjudication to undermine the impartial development of securities law); Joseph A. Grundfest, *Fair or Foul? SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 85 Fordham L. Rev. 1143, 1148 (2016) (by litigating administratively, the SEC seeks to control the interpretation of federal securities laws); *cf. Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 824–25 (1986).

When the SEC's adjudication concludes with the usual (and largely predictable) result of a final decision in its own favor, the respondent may seek review of the decision in a federal court of appeals, 15 U.S.C. § 78y, but that review is circumscribed. The Commission's conclusions of law are typically entitled to significant deference under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) and *Auer v. Robbins*, 519 U.S. 452 (1997), and courts frequently acquiesce to the Commission's self-serving views of securities law, *see VanCook v. SEC*, 653 F.3d 130, 140 n.8 (2d Cir. 2011) (SEC's interpretation of securities law "trumps" Second Circuit precedent (quoting *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982 (2005)));

SEC v. Tex. Gulf Sulphur, Co., 401 F.2d 833, 848 (2d Cir. 1968) (adopting SEC's novel interpretation that insider trading constitutes fraud in violation of Exchange Act Section 10(b)). And the Commission's factual findings—often rubber-stamped from the initial ALJ hearing—are conclusive if supported by "substantial evidence," 15 U.S.C. § 78y(a)(4), a notoriously undemanding standard permitting reversal only where "no reasonable factfinder could reach a contrary conclusion." *Chen v. Gonzales*, 470 F.3d 1131, 1134–41 (5th Cir. 2006). Federal court review is thus often an empty promise.

The resulting reality of the SEC's administrative adjudication process is that the deck is stacked heavily against the respondent from start to finish, with the burden of proof effectively on the respondent rather than the government, where it rightly belongs in this kind of quasi-criminal prosecution. *Cf. Patterson v. New York*, 432 U.S. 197, 211 (1977) ("[T]he universal rule in this country [is] that the prosecution must prove guilt beyond a reasonable doubt."). As a former ALJ put it, "the burden was on the people who were accused to show that they didn't do what the agency said they did." Eaglesham, *SEC Wins with In-House Judges*, *supra*. And the cumulative effect is predictable: Most respondents, with the looming threat of a process skewed against them, understandably cry uncle rather than rolling the dice with costly hearings and years of uphill appeals. *See* Velikonja, 92 Wash. L. Rev. at 315, 340, 346–47.

The SEC's new authority to impose harsh punitive sanctions against private, non-registered parties in these inherently biased administrative proceedings has only increased the agency's leverage in settlement negotiations. *See* Choi, 34 Yale J. on Reg. at 16 (confirming empirically hypothesis "that the SEC would use its additional enforcement powers under the Dodd-Frank Act as leverage to obtain greater monetary penalties in administrative proceedings"); Velikonja, 92 Wash. L. Rev. at 365 ("willingness to settle may be affected by their perception that ALJs are less fair"). For its part, at least the Commission is honest about what it's up to: A recent Enforcement Division head admitted that "there have been a number of cases in recent months where we have threatened administrative proceedings … and they settled." Brian Mahoney, *SEC Could Bring More Insider Trading Cases In-House*, Law360 (June 11, 2014). One hardly wonders why.

CONCLUSION

Where private rights are implicated, the Commission's biased, one-sided administrative proceedings should not pass muster. This Court should vacate the Commission's order and remand this matter to the agency with instructions that, in any subsequent proceeding, Jarkesy be afforded all the rights secured by the Constitution.

Respectfully submitted,

/s/ Russell G. Ryan
Russell G. Ryan
Ashley C. Parrish
Gabriel Krimm
KING & SPALDING LLP
1700 Pennsylvania Ave. NW
Washington, DC 20006
(202) 797-0500
RRyan@kslaw.com

I. Cason Hewgley IV
KING & SPALDING LLP
1100 Louisiana St., Ste. 4100
Houston, TX 77002

Ilya Shapiro
Jennifer J. Schulp
CATO INSTITUTE
1000 Mass. Ave. NW
Washington, DC 20001
(202) 842-0200
ishapiro@cato.org

Counsel for Amicus Curiae

March 17, 2021

CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of March, 2021, an electronic copy of the foregoing brief was filed with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit using the appellate CM/ECF system, and that service will be accomplished by the appellate CM/ECF system upon the following registered CM/ECF users:

Karen L. Cook	karen@karencooklaw.com
S. Michael McColloch	smm@mccolloch-law.com
Daniel J. Aguilar	daniel.j.aguilar@usdoj.gov
Paul. G. Alvarez	alvarezp@sec.gov
Dominick V. Freda	fredad@sec.gov

I further certify that service will be accomplished via U.S. Mail upon the following non-registered user:

Brent J. Fields
U.S. Securities &
Exchange Commission
Mail Stop 1090
100 F Street, N.E.
Washington, DC 20549
202-551-5400

/s/ Russell G. Ryan
Russell G. Ryan

Counsel for Amicus Curiae

CERTIFICATE OF COMPLIANCE

The undersigned counsel for *amicus* certifies that:

1. No privacy redactions were required in this brief.

2. Any required hard copies of this brief are exact copies of the ECF filing dated March 17, 2021.

3. The ECF submission was scanned for viruses with the most recent version of McAfee Endpoint Security, and, according to the program, is free of viruses.

4. This brief complies with the word limits of Fed. R. App. P. 29(a)(5) and 32(a)(7)(B) because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), it contains 6,077 words.

5. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6), because it has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Century Schoolbook font.

Dated: March 17, 2021

/s/ Russell G. Ryan
Russell G. Ryan

Counsel for Amicus Curiae