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U.S. SEC weighs constitutional challenge to its in-house courts

WASHINGTON, JUNE 8 | BY SARAH N. LYNCH

The top U.S. securities regulator on Monday considered whether its own in-house procedure to handle securities enforcement cases violated the U.S. Constitution.

In an unusual hearing before a standing room-only audience, trial lawyers for the U.S. Securities and Exchange Commission sought to convince the regulator's commissioners of the legality of SEC administrative proceedings.

The case involved Timbervest LLC, which was seeking to overturn an August decision by SEC Administrative Law Judge Cameron Elliot finding the Georgia-based investment firm and top executives liable for fraud for having failed to disclose conflicts of interest and various fees.

But the case has drawn interest because Timbervest, like other defendants in similar cases, has argued that the entire administrative proceeding was unconstitutional because of the job protections afforded judges like Elliot.

Many similar types of constitutional challenges by other defendants have not met with much success.

However, on the same day Timbervest was presenting its appeal, a federal judge in Atlanta issued a ruling on another case that could prove to be a turning point.

U.S. District Judge Leigh Martin May agreed on Monday to halt the SEC's administrative proceeding against Charles Hill, a real estate developer accused of insider trading, based on similar constitutional arguments.

Administrative law judges are considered independent from the government agencies where they work. Their employing agency can seek their removal, but such a move must also be reviewed by the Merit Systems Protection Board.

Timbervest claimed that SEC judges qualify as "inferior officers" subject to removal by U.S. President [Barack Obama](#). Its lawyers said the extra layer of job protection afforded to the judges violates the separation of powers under the Constitution because Obama might be unable to remove them, even for cause.

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The SEC disagrees, calling administrative law judges "employees," not inferior officers, saying that SEC commissioners can review their decisions and have discretion on when to use the in-house courts.

The Atlanta judge in Hill's case declared Monday that she believes SEC judges are likely inferior officers, and therefore the "plaintiff has established a likelihood of success on the merits" of his claim.

In its appeal, Timbervest has also challenged Elliot's track record of ruling against defendants in SEC administrative cases.

The SEC issued an unusual order last week inviting Elliot to say whether he feels pressure to rule for the regulator. [ID: nL1N0YR139]

The SEC will now weigh the arguments and eventually rule on Timbervest's appeal.

SEC administrative proceedings became more common after the Dodd-Frank financial reforms became law in 2010.

Defendants complain that the proceedings deprive them of protections afforded in federal courts.

(Reporting by Sarah N. Lynch; Editing by Lisa Shumaker)

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