No. 19–

IN THE

Supreme Court of the United States

CRAIG R. JALBERT, IN HIS CAPACITY AS TRUSTEE FOR F2 LIQUIDATING TRUST, on behalf of himself and all others similarly situated,

Petitioner,

v.

U.S. SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

PETITION FOR WRIT OF CERTIORARI

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May 18, 2020

QUESTIONS PRESENTED

Whether a federal government agency commits a structural separation-of-powers violation of exercising a legislative function when, in addition to explicitly authorized penalties, it obtains other penalties under the label of "disgorgement," which were not authorized by Congress and the imposition of which conflicts with the congressional statutory punitive and remedial scheme.

Whether a waiver of judicial review by a respondent in connection with a settlement agreement with a federal government agency is valid and enforceable against that respondent in an action by the respondent claiming that the agency committed a structural separation-of-powers violation by extracting from the respondent a penalty labeled "disgorgement" that Congress did not authorize and which was imposed in addition to what the agency found to be the appropriate statutory penalty.

Whether a federal government agency's order imposing unauthorized penalties labeled "disgorgement" is void in relevant respects because the agency did not have the power to impose penalties without explicit congressional authorization.

PARTIES TO THE PROCEEDINGS

Petitioner, Craig R. Jalbert, in his capacity as trustee for F2 Liquidating Trust (the "Trust"), was the plaintiff in the proceedings in the United States District Court for the District of Massachusetts (the "District Court") and the appellant in the United States Court of Appeals for the First Circuit (the "First Circuit").

Respondent, the Securities and Exchange Commission (the "SEC"), was the defendant in the District Court and the appellee in the First Circuit.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, the undersigned counsel of record for the Trust hereby states that the Trust has no parent corporation and that no publicly held company owns 10% or more of its stock.

DIRECTLY RELATED PROCEEDINGS

-United States District Court for the District of Massachusetts: *Craig R. Jalbert v. Securities & Exchange Commission*, No. 1:17-cv-12103-FDS. An order of dismissal entered in the District Court on August 22, 2018.

-United States Court of Appeals for the First Circuit: *Craig R. Jalbert v. U.S. Securities & Exchange Commission*, No. 18-2043. Judgment entered in the First Circuit on December 20, 2019.

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The First Circuit's opinion (Appendix ("App.") 1a-19a) is reported at 945 F.3d 587. The District Court's memorandum and order granting the SEC's motion to dismiss (App. 20a-45a) is reported at 327 F. Supp. 3d 287. The SEC's administrative order instituting and settling the SEC enforcement proceeding against F-Squared Investments, Inc. ("F-Squared") is unreported but is available on the District Court docket (No. 1:17-cv-12103-FDS) at ECF No. 1-1.

JURISDICTION

The First Circuit entered its judgment on December 20, 2019. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1). This petition is timely filed. The initial deadline to file this petition was March 19, 2020. *See* U.S. Sup. Ct. R. 13.1. However, on that date, this Court entered an order extending the deadline to file any petition for a writ of certiorari due on or after March 19, 2020 to 150 days from the date of the lower court judgment.

RELEVANT STATUTORY AND REGULATORY PROVISIONS

The following relevant statutory and regulatory provisions are reproduced in the Appendix (App. 46a-91a) in accordance with Supreme Court Rule 14.1(f): 15 U.S.C. §§ 80a-9(e) and 80b-3(j), and 17 C.F.R. § 201.240.

STATEMENT OF THE CASE

A. Introduction

In its understandable and admirable zeal to stamp out securities fraud, the SEC has decided that the penalty amounts it was statutorily authorized to collect were insufficient to achieve its law-enforcement objectives of punishment and deterrence. Rather than go to Congress and ask for expanded powers, as the Constitution contemplates in such circumstances, the SEC engaged in self-help. It chose to convert congressional authorization to obtain disgorgement in limited circumstances for the benefit of victims into penalties labeled "disgorgement." By doing so, the SEC chose to disregard the will of Congress and substituted its own judgment for the judgment of the constitutional branch of government that created it. Whatever its intentions, an administrative agency of the United States must abide by the laws that apply to it. It is the province of Article III courts to make sure that it does.

F-Squared was an investment management firm that marketed an investment logarithm that provided investment-decision (buy or sell) signals for use by investment advisors. In its marketing, F-Squared misrepresented how the investment strategies were tested. F-Squared represented to its clients that the strategy had been used for many years in live trading. In fact, the investment strategy was back-tested, i.e., its efficacy was determined by analyzing how it would have performed had it been used in live trading in the past.

Although the SEC appropriately investigated and brought an administrative enforcement action against F-Squared for this conduct, the back-tested model was actually successful, and no client lost money as a result. The SEC enforcement action was resolved in December 2014 by an administrative settlement with F-Squared. F-Squared agreed, as part of the settlement, to pay the SEC a total sum of $35 million in civil penalties ($5 million) and purported disgorgement ($30 million). The entire $35 million sum was then wired by F-Squared to the U.S. Treasury; none of the money was used to recompense victims. The SEC also extracted from F-Squared, as it does in all its settlements, an agreement to waive judicial review in any court.

Because no investor was harmed by F-Squared's conduct, the only victims in this case were F-Squared's creditors, whose bills went unpaid when F-Squared was forced to file bankruptcy not long after wiring the $35 million into the U.S. Treasury. The Trust filed this lawsuit under the Administrative Procedure Act ("APA") challenging the SEC's unauthorized collection of "disgorgement" that operated as a penalty under the analysis of *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). Rather than defend its extraction of disgorgement on the merits, the SEC claimed that the Trust's claims had been waived by F-Squared. Both the District Court and the First Circuit accepted the SEC's waiver argument. Those decisions of the lower courts conflict with several decisions of this Court.

The federal securities laws permit the SEC to obtain non-punitive disgorgement in

administrative proceedings, but only where certain criteria are met. First, the disgorgement order must be accompanied by an accounting—a determination of the amount of illicit gain, factoring in deductions for any expenses. Second, the disgorged proceeds must be paid to the investors who have been harmed by the securities violation. The relevant statutory text unambiguously demonstrates that the disgorgement authorized in administrative proceedings must be remedial, non-punitive relief. The First Circuit acknowledged the Trust's reading of the statute, *see* 945 F.3d at 591-92, but did not address it in its decision.

The "disgorgement" extracted from F-Squared by the SEC, however, constituted a penalty. Because the money was not disbursed to victims but was instead directed to the U.S. Treasury, it was clearly imposed for law-enforcement purposes: to punish and deter. It was, therefore, a penalty under *Kokesh*. *See* 137 S. Ct. at 1639, 1643-45.[1] In other words, the SEC determined that the appropriate monetary penalty under the penalty provisions of the federal securities laws was $5 million. Nonetheless, it imposed an additional penalty of $30 million under the "disgorgement" label.

This "disgorgement" penalty was unauthorized. An agency has no power to impose a penalty unless there is clear statutory

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[1] To be clear, the Trust is *not* alleging that there can never be an appropriate use of disgorgement in SEC administrative proceedings that comports with statutory requirements. That did not happen in F-Squared's case, however.

authority to do so. *See La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986); *C.I.R. v. Acker*, 361 U.S. 87, 91 (1959). No statute authorizes the SEC to impose penal disgorgement.

By imposing this unauthorized penalty, the SEC arrogated to itself legislative power. The creation of penalties is a legislative power that belongs solely to Congress. *See Whalen v. United States*, 445 U.S. 684, 689 (1980). Penal disgorgement is not the product of congressional action. It was instead created by a federal agency. The SEC cannot confer power on itself, *see La. Pub. Serv. Comm'n*, 476 U.S. at 374, which is precisely what it attempted to do in its agreement with F-Squared.

The SEC's usurpation of Congress's legislative power to create penalties constitutes a structural separation-of-powers violation. *See Welch v. United States*, 136 S. Ct. 1257, 1268 (2016); *Whalen*, 445 U.S. at 689. Because the Trust's claim exposes a structural separation-of-powers violation, the First Circuit's waiver holding is wrong: unlike claims based on personal constitutional rights, structural separation-of-powers violations cannot be waived by the parties. *See Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 850-51 (1986). The need to guard against the arrogation by one branch of the federal government of power belonging to another branch is a constitutional imperative that transcends any one case; private parties cannot be expected to protect this structural interest. For these reasons, this Court has held that private parties like F-Squared cannot waive or cure structural separation-of-powers violations by consent or agreement.

For similar reasons, the order by which the SEC extracted the disgorgement from F-Squared along with F-Squared's waiver of judicial review is void in relevant respects. Therefore, the Trust is not barred from challenging the void portion of the order through which the SEC extracted a penalty labeled "disgorgement" from F-Squared. *See United States v. U.S. Fidelity & Guar. Co.*, 309 U.S. 506, 512 (1940).

The First Circuit's waiver holding—the sole ground of its decision—is inconsistent with the above-cited decisions of this Court. Therefore, this Court should grant certiorari to review the important federal questions presented by the SEC's conduct in this case. *See* U.S. Sup. Ct. R. 10(c).

B. Factual Background

F-Squared was an investment management firm headquartered in Massachusetts. *See Complaint*, No. 1:17-cv-12103-FDS, ECF No. 1 ("*Compl.*"), at ¶ 57. The SEC charged, and F-Squared admitted, that F-Squared sold an investment strategy by misrepresenting its performance track record, which was inflated, hypothetical, and back-tested. *Id.* at ¶¶ 58, 62. Notwithstanding these misrepresentations, however, F-Squared's model outperformed the market. *Id.* at ¶ 62. As a result, F-Squared's clients (who were other investment managers) were not harmed; indeed, they continued to trade more and more of their own clients' securities on the basis of F-Squared's trading signals, with positive results. *Id.*

By order dated December 22, 2014, the SEC initiated and settled an SEC enforcement proceeding against F-Squared for violations of Sections 203(e) and 203(k) of the Investment Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act. *See id.* at ¶ 58. After deeming it to be "appropriate and in the public interest," No. 1:17-cv-12103-FDS, ECF No. 1-1, at 1, the SEC determined that the appropriate amount of civil penalties to be imposed on F-Squared was $5 million, which F-Squared paid in full and which is not at issue in this case. *See Compl.* at ¶¶ 58-59.

The SEC also extracted an additional $30 million payment as purported "disgorgement," which bore no relation to investor losses because none resulted from F-Squared's conduct. *See id.* at ¶¶ 58, 61. The SEC offered no explanation of how it calculated this $30 million sum. With no need to recompense any purported investor victims, the SEC directed F-Squared to wire the $30 million "disgorgement" payment to the U.S. Treasury. *See id.* at ¶¶ 61, 63.

As required by Rule 240 of the SEC Rules of Practice, F-Squared waived a host of procedural rights as part of its offer of settlement, including judicial review in any court. *See* 17 C.F.R. § 201.240(b), (c)(4)(v); *Offer of Settlement*, No. 1:17-cv-12103-FDS, ECF No. 23-1, at 2. F-Squared was forced to file for bankruptcy less than eight months after making the $30 million unlawful "disgorgement" payment. *See Compl.*, at ¶ 60. As a result of that bankruptcy filing, the Trust's clients—F-Squared's trade and other non-investor creditors—were left with unpaid bills. The Trust

brought this action seeking the repayment of F-Squared's money extracted by the SEC as an unlawful penalty under the label of "disgorgement" as a means of compensating these creditors.

C. Procedural Background

The complaint in this case is a logical outgrowth of *Kokesh* and its clear implications. The Trust seeks to represent a class of entities and individuals who were forced by the SEC to make payments labeled "disgorgement" that were in fact unauthorized, non-statutory, additional penalties. *See id.* at ¶¶ 44-73. The class-action complaint states claims under the APA challenging the SEC's policy and practice (both historical and current) of obtaining unlawful penalties labeled "disgorgement" and without observing the relevant statutory requirements. *See id.* at ¶¶ 13-40. The District Court had subject-matter jurisdiction of the Trust's APA claims pursuant to 28 U.S.C. § 1331.

The SEC moved to dismiss the complaint, and the District Court granted that motion. (App. 20a-45a.) The Trust timely appealed to the First Circuit, *see* 945 F.3d at 590, which had jurisdiction over the appeal pursuant to 28 U.S.C. § 1291. The First Circuit affirmed the dismissal of the Trust's claim solely on the basis that "[the Trust] failed to state a claim upon which relief could be granted inasmuch as [F-Squared] waived judicial review by any court." 945 F.3d at 589; *see also id.* at 591. The Trust timely filed the instant petition for writ of certiorari.

ARGUMENT

I. The SEC's Action Amounts to a Non-Waivable Structural Separation-of-Powers Violation.

The sole ground of the First Circuit's affirmance of the dismissal of the Trust's complaint was that the complaint failed to state a claim upon which relief may be granted because F-Squared waived judicial review in any court in connection with its settlement with the SEC. *See id.* at 593-94. The court below reasoned that the Trust's claim did "not implicate a structural separation-of-powers issue," *id.* at 592, and that, therefore, F-Squared's waiver of judicial review was valid and enforceable.

This decision is incompatible with numerous decisions of this Court. It is clear from this Court's jurisprudence that obtaining extra-statutory penalties under the label of "disgorgement" is an arrogation to the SEC of exclusive legislative power: the power to create penalties. An executive agency's exercise of legislative power reserved exclusively to Congress by the Constitution represents a structural separation-of-powers violation that cannot be waived.

A. The Decisions of this Court Demonstrate that the SEC has Committed a Structural Separation-of-Powers Violation by Arrogating to Itself the Legislative Power to Create Penalties.

The doctrine of separation of powers is a foundational principle that is central to the very structure of the federal government. *See Freytag v. C.I.R.*, 501 U.S. 868, 870 (1991) ("The leading Framers of our Constitution viewed the principle of separation of powers as the central guarantee of a just government."). The structural interests served by the doctrine consequently belong to the entire republic rather than individual litigants who may or may not raise these issues depending on their parochial interests and litigation strategy. *See id.* at 880 ("The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic."); *see also Bond v. United States*, 564 U.S. 211, 222 (2011) (explaining that "[t]he structural principles secured by the separation of powers protect the individual as well" as "each branch of government from incursion by the others").

The main focus of this Court's separation-of-powers jurisprudence is "the danger of one branch's aggrandizing its power at the expense of another branch." *Freytag*, 501 U.S. at 878; *see also Loving v. United States*, 517 U.S. 748, 757 (1996) ("[I]t remains a basic principle of our constitutional scheme that one branch of the Government may not intrude upon the central prerogatives of another."); *INS v. Chadha*, 462 U.S. 919, 951 (1983) ("The hydraulic pressure

inherent within each of the separate Branches to exceed the outer limits of its power, even to accomplish desirable objectives, must be resisted."). This case involves such an impermissible inter-branch usurpation of power.

1. The Power to Create Penalties is a Legislative Power Belonging Solely to Congress.

The creation of penalties is a legislative power, residing wholly within Congress. *See Whalen*, 445 U.S. at 689 (referring to the "basic principle that within our federal constitutional framework the legislative power, including the power to define criminal offenses and to prescribe the punishments to be imposed upon those found guilty of them, resides wholly with the Congress"); *United States v. Evans*, 333 U.S. 483, 486 (1948) ("In our system, so far at least as concerns the federal powers, defining crimes and fixing penalties are legislative, not judicial, functions."); *L.P. Steuart & Bro., Inc. v. Bowles*, 322 U.S. 398, 404 (1944) ("[I]t is for Congress to prescribe the penalties for the laws which it writes."); *United States v. Wiltberger*, 18 U.S. 76, 95 (1820) (Marshall, C.J.) ("[T]he power of punishment is vested in the legislative, not in the judicial department. It is the legislature, not the Court, which is to define a crime, and ordain its punishment."); *cf. Whitman v. United States*, 574 U.S. 1003, 135 S. Ct. 352, 354 (2014) (statement of Scalia, J., with whom Thomas, J., joined, respecting denial of certiorari) ("[O]nly the *legislature* may define crimes and fix punishments. Congress cannot,

through ambiguity, effectively leave that function to the courts—much less to the administrative bureaucracy.").

For this reason, one can be subjected to a penalty if and only if a duly passed statute—the manifestation of Congress's legislative power—plainly imposes that penalty. *See Acker*, 361 U.S. at 91 ("The law is settled that penal statutes are to be construed strictly, and that one is not to be subjected to a penalty unless the words of the statute plainly impose it." (internal citations and quotation marks omitted)). It logically follows that if a statute enacted by Congress does not plainly impose a certain penalty, an agency has no authority to extract that penalty. *See* 33 Charles Alan Wright et al., *Federal Practice & Procedure* § 8419, at 443 (2d ed. 2018) ("[A]n agency's power to impose penalties and penal statutes is to be strictly construed, and an agency may order a penalty only where the words of the statute plainly impose it." (quotation marks omitted)); *see generally La. Pub. Serv. Comm'n*, 476 U.S. at 374 (recognizing that "an agency literally has no power to act" absent conferral of power upon it by Congress).

2. <u>Congress has Enacted a Carefully Constructed Remedial Framework in the Securities Context that Does Not Authorize Punitive Disgorgement</u>.

In the securities context, as it relates to administrative proceedings initiated by the SEC, Congress has carefully enacted a comprehensive statutory scheme setting forth the SEC's

enforcement tools, including civil penalties and the separate relief of accounting-and-disgorgement orders. Congress authorized the SEC to seek two types of relief for violations of the securities laws: (1) monetary civil penalties, subject to explicit statutory maximums, *see* 15 U.S.C. § 78u-2(a)-(c); *id.* § 80a-9(d); *id.* § 80b-3(i); and (2) the remedial relief of accounting-and-disgorgement orders for the benefit of investors, *see id.* § 78u-2(e); *id.* § 80a-9(e); *id.* § 80b-3(j) (collectively, the "accounting-and-disgorgement provision").

The civil-penalty subsection of the statute, which is entitled "Money penalties in administrative proceedings," *id.* § 80a-9(d); *id.* § 80b-3(i), sets forth the circumstances in which the SEC "may impose a civil penalty." *Id.* § 80a-9(d)(1); *id.* § 80b-3(i)(1); *see also id.* § 78u-2(a). The penalties provision also lays out a three-tiered system for civil penalties: (1) penalties under the first tier cannot exceed $5,000 per violation for a natural person and $50,000 per violation for any other person; (2) the maximums for the second tier, which applies where the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," are increased to $50,000 for natural persons and $250,000 for others; and (3) third-tier penalties, which are available where the requisite culpable conduct for tier two is present *and* the violation resulted in substantial losses to others or substantial pecuniary gain to the respondent, increase to maximums of $100,000 for natural persons and $500,000 for all others. *See id.* § 80a-9(d)(2); *id.* § 80b-3(i)(2);*see also id.* § 78u-2(b). Finally, the civil-penalty

subsection sets forth several factors to guide the SEC's determination of whether imposition of a civil penalty is in the public interest. *See id.* § 80a-9(d)(3); *id.* § 80b-3(i)(3);*see also id.* § 78u-2(c). Those public-interest factors include: whether the conduct involved fraud, deceit, manipulation, or deliberate, or reckless disregard of a regulatory requirement; whether the respondent has a history of previous noncompliance with the securities laws; and the need to deter the respondent and other persons from committing similar violations. *See id.* § 80a-9(d)(3); *id.* § 80b-3(i)(3).[2]

The separate accounting-and-disgorgement provision is labeled "Authority to enter order requiring accounting and disgorgement." It provides:

> In any proceeding in which the Commission may impose a penalty under this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

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[2] In F-Squared's case, the SEC determined that it was "appropriate and in the public interest" to impose a $5 million civil penalty on F-Squared. No. 1:17-cv-12103-FDS, ECF No. 1-1, at 1; *see id.* at 14.

Id. § 80a-9(e); *id.* § 80b-3(j); *see also id.* § 78u-2(e) (containing substantially similar language). The unambiguous text and structure of this provision make clear that Congress authorized "accounting and disgorgement" only as remedial, non-punitive relief.

The language of the authorization to impose accounting and disgorgement demonstrates that disgorgement is not a penalty. To begin, Congress's use of the different terms "order requiring accounting-and-disgorgement" and "penalty" in this statute was purposeful. *See Corley v. United States*, 556 U.S. 303, 315 (2009) ("Congress used both terms in [the statute] itself, and '[w]e would not presume to ascribe this difference to a simple mistake in draftsmanship'" (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983))). By differentiating between penalty and disgorgement in this way, Congress explicitly separated penal portions of the SEC's enforcement authorization from the remedial portion.

Another clear indication that disgorgement was not intended to be used as a penalty is that the accounting-and-disgorgement provision authorizes the SEC to obtain disgorgement "[i]n any proceeding in which the Commission *may* impose a penalty," 15 U.S.C. § 80a-9(e) (emphasis added); *id.* § 80b-3(j) (emphasis added), and regardless of the severity of the respondent's conduct. The civil-penalty provision of the statute, on the other hand, directs the SEC to consider a number of factors that are tied directly to punitive purposes, including the severity of the respondent's

conduct; the respondent's history of prior noncompliance with the securities laws; and "*the need to deter* [the respondent] and other persons." *Id.* § 80a-9(d)(3) (emphasis added); *id.* § 80b-3(i)(3) (emphasis added).

Two things follow from these clear distinctions in the statutory text: one, disgorgement is something different from a penalty because it may be imposed in addition to penalties and even if the SEC decides that imposition of penalties would not be in the public interest; and two, disgorgement is not meant to serve a penal purpose because it is not meant to be calibrated to achieve law-enforcement objectives of punishment and deterrence as the penalty provisions are. This is sensible; the severity of harm to investors is, in many cases, independent of the severity of a violation. Even a negligent violation that does not call for severe punishment could lead to substantial investor harm. By granting authority to impose accounting and disgorgement in any administrative proceeding in which the SEC may impose a penalty, Congress made clear that the purpose of disgorgement is remedial, not an infliction of additional punishment.

Furthermore, when both sentences of the accounting-and-disgorgement provision are read as a whole (as they are required to be read, *see Corley*, 556 U.S. at 314 n.5), it is clear that Congress authorized disgorgement only where the disgorged proceeds will be used for harmed investors. The first sentence—authorizing "accounting and disgorgement"—is not self-executing because it provides no specificity as to what form the accounting and disgorgement

should take or to whom accounting-and-disgorgement proceeds should be paid. It is the second sentence that provides the necessary specificity and thereby gives force to the first sentence. The second sentence explicitly deals with the *implementation* of the authority given by the first sentence. "[T]o implement" the accounting-and-disgorgement provision, the second sentence authorizes the SEC to adopt rules, regulations, and orders that relate to remitting funds to victims: "payments to investors." 15 U.S.C. § 78u-2(e); *id.* § 80a-9(e); *id.* § 80b-3(j).[3] The second sentence makes it clear that this provision must be read as authorizing the SEC to disburse disgorged funds to harmed investors and nothing else.

Congress's choice of the words "accounting and disgorgement" further demonstrates that this provision authorizes only remedial, non-

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[3] The remaining items listed in the second sentence—rates of interest and periods of accrual—relate to payments to investors: adding interest to the recoverable amount for the benefit of investors so as to recompense them for any income they could have earned with the money that was wrongfully taken from them by the defendant. And the general catchall phrase that follows the list with the conjunction "and"—"and such other matters as it deems appropriate to implement this subsection"—must be similarly interpreted as relating to payments to investors. *See Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1625 (2018) ("[W]here, as here, a more general term follows more specific items in a list, the general term is usually understood to 'embrace only objects similar in nature to those objects enumerated by the preceding specific words.'" (quoting *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001))).

punitive relief. Each of the words "accounting" and "disgorgement" refers to a type of relief that is wholly distinct from, and has different purposes than, civil penalties. *See Kokesh*, 137 S. Ct. at 1640 ("[D]isgorgement is a form of '[r]estitution measured by the defendant's wrongful gain.' Disgorgement requires that the defendant give up 'those gains . . . properly attributable to the defendant's interference with the claimant's legally protected rights.'" (citation omitted) (quoting Restatement (Third) of Restitution and Unjust Enrichment ("Restatement") § 51, cmt. a, at 204 (2010))); *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 214 n.2 (2002) (explaining that "an accounting for profits" is "a form of equitable restitution").[4]

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[4] *See also* Restatement, *supra*, § 51(4) ("[T]he unjust enrichment . . . is the net profit attributable to the underlying wrong. The object of restitution in such cases is to eliminate profit from wrongdoing while avoiding, so far as possible, the imposition of a penalty. Restitution remedies that pursue this object are often called 'disgorgement' or 'accounting.'"); *id.*, cmt. a ("Restitution measured by the defendant's wrongful gain is frequently called 'disgorgement.' Other cases refer to an 'accounting' or an 'accounting for profits.' Whether or not these terms are employed, the remedial issues in all cases of conscious wrongdoing are the same. They concern the identification and measurement of those gains to the defendant that should be regarded as unjust enrichment, in that they are properly attributable to the defendant's interference with the claimant's legally protected rights."); *id.*, cmt. h ("[M]aking the defendant liable in excess of [its] net gains[] results in a punitive sanction that the law of restitution normally attempts to avoid.").

A separate section of the securities laws, confirms the Trust's interpretation of the accounting-and-disgorgement provision. *See Boumediene v. Bush*, 553 U.S. 723, 776 (2008) ("When interpreting a statute, we examine related provisions in other parts of the U.S. Code."). Section 7246 further cements the clear dichotomy that Congress created between civil penalties and accounting-and-disgorgement orders. That section authorizes the SEC to add the amount of a civil penalty to "a disgorgement fund or other fund established for the benefit of the victims" of the violation of the securities laws. 15 U.S.C. § 7246(a). This section demonstrates Congress's understanding that there will be circumstances when—by application of proper disgorgement analysis—the amount of illicit gain attributable to the wrongdoing that may be disgorged will be insufficient to address the harm to investors adequately. To narrow any shortfall, Congress allowed the SEC to use civil penalties collected from a respondent to reduce the financial harm to victims.

In sum, it is clear from the unambiguous language and structure of the accounting-and-disgorgement provision and surrounding provisions of the securities laws that the accounting-and-disgorgement provision authorizes only remedial, non-punitive relief. That provision is not a second penalty provision, and it clearly does not plainly authorize the SEC to extract a penalty in addition to authorized civil penalties. *See Acker*, 361 U.S. at 91.

3. The SEC has Usurped the Legislative Power to Create Penalties by Using Disgorgement in an Unauthorized Penal Fashion.

The SEC has disregarded this carefully constructed congressional scheme and has instead persisted in its practice of extracting an unauthorized, duplicate penalty under the label of "disgorgement." *See Kokesh*, 137 S. Ct. at 1640 ("The [Securities Enforcement Remedies and Penny Stock Reform] Act left the Commission with a full panoply of enforcement tools: It may promulgate rules, investigate violations of those rules and the securities laws generally, and seek monetary penalties and injunctive relief for those violations. In the years since the Act, however, the Commission has continued its practice of seeking disgorgement in enforcement proceedings.").

In *Kokesh*, this Court unanimously held that what the SEC labels as "disgorgement" is not remedial and instead constitutes a penalty because: (1) the SEC imposes "disgorgement" for the punitive purpose of deterrence; (2) the SEC orders "disgorgement" without attempting to trace the ill-gotten gains or even to quantify the amount of any illicit profit; and (3) "SEC disgorgement is not compensatory," as demonstrated by the SEC's practice of disbursing disgorged funds into the U.S. Treasury instead of recompensing harmed investors. *See id.* at 1639, 1642, 1643-45. All three of these penal aspects of SEC disgorgement apply to the amount that the SEC extracted from F-Squared.

What the SEC has done, then, is to disregard clearly expressed congressional will in favor of its own policy choices about what enforcement tools were necessary for effective policing of compliance with the federal securities laws. This constitutes a quintessential structural separation-of-powers violation: an agency has disregarded the language of the statute and usurped legislative power—the power to create penalties—by using the "disgorgement" label to mask the extraction of a duplicative penalty that is not plainly imposed by the statutes Congress enacted. *See Whalen*, 445 U.S. at 689 ("If a federal court exceeds its own authority by imposing multiple punishments not authorized by Congress, it violates not only the specific guarantee against double jeopardy, but also the constitutional principle of separation of powers in a manner that trenches particularly harshly on individual liberty."); *see also Welch*, 136 S. Ct. at 1268 ("[T]he separation of powers prohibits a court from imposing criminal punishment beyond what Congress meant to enact. But a court likewise is prohibited from imposing criminal punishment beyond what Congress in fact has enacted by a valid law. In either case a court lacks the power to exact a penalty that has not been authorized by any valid criminal statute." (internal citation and parenthetical omitted)); *L.P. Steuart*, 322 U.S. at 404 ("It would transcend both the judicial and the administrative function to make additions to

those [penalties] which Congress has placed behind a statute.").[5]

The First Circuit's failure to recognize the structural separation-of-powers violation in this case fatally undermines its waiver holding.

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[5] Contrary to the suggestion of the opinion below, *see* 945 F.3d at 593, this Court's decision in *City of Arlington v. FCC*, 569 U.S. 290 (2013), is inapposite. The Court in *City of Arlington* was determining whether an agency's interpretation of ambiguous statutory language concerning the scope of the agency's authority was entitled to *Chevron* deference. *See City of Arlington*, 569 U.S. at 297-98. Put differently, the question in that case was whether Congress, in fact, deliberately gave the agency the leeway to expand its regulatory scope as necessary to implement Congressional authorization. Both the majority opinion and the dissent in that case recognized that, where Congress has spoken in clear and unambiguous terms, that is the end of the matter. *See id.* at 296; *id.* at 314. Such is the case here, where the unambiguous language of the securities laws demonstrates that the accounting-and-disgorgement provision authorizes only remedial, non-punitive relief. *Cf. Fed. Trade Comm'n v. Credit Bureau Ctr., Inc.*, 937 F.3d 764, 767 (7th Cir. 2019) (applying this Court's decision in *Meghrig v. KFC W., Inc.*, 516 U.S. 479, 487-88 (1996), to overrule circuit precedent and to hold that a statute's express and unambiguous remedial scheme foreclosed the agency's interpretation of an implied restitutionary remedy). *City of Arlington* therefore has no application here. That case also did not involve a structural separation-of-powers violation like the one present here.

B. Structural Separation-of-Powers Violations Like the One in this Case Cannot be Waived.

Although parties can waive personal constitutional rights, they cannot waive structural separation-of-powers violations because the separation-of-powers doctrine serves structural interests that private parties cannot be expected to protect. This Court's decision in *Schor* demonstrates this point.

In that case, Schor commenced proceedings before the Commodity Futures Trading Commission ("CFTC") and litigated his claims and the defendant's counterclaim to judgment before an administrative law judge. 478 U.S. at 837-38. After an adverse decision, Schor challenged—for the first time—the CFTC's authority to adjudicate the counterclaim, *id.* at 838, and contended that the CFTC's adjudication of the counterclaim violated separation-of-powers principles, *see id.* at 847.

This Court first determined that Schor waived his personal right to a trial before an Article III court by proceeding to judgment in the CFTC. *See id.* at 849 ("Schor indisputably waived any right he may have possessed to the full trial of Conti's counterclaim before an Article III court. Schor expressly demanded that Conti proceed on its counterclaim in the reparations proceeding rather than before the District Court . . . and was content to have the entire dispute settled in the forum he had selected until the ALJ ruled against him on all counts; it was only after the ALJ rendered a decision to which he

objected that Schor raised any challenge to the CFTC's consideration of Conti's counterclaim.").

This Court nonetheless considered the structural separation-of-powers claim on the merits, notwithstanding Schor's undeniable waiver of his personal Article III claim. *See id.* at 850-51. This Court explained:

> Article III, § 1, not only preserves to litigants their interest in an impartial and independent federal adjudication of claims within the judicial power of the United States, but also serves as an inseparable element of the constitutional system of checks and balances. Article III, § 1 safeguards the role of the Judicial Branch in our tripartite system by barring congressional attempts to transfer jurisdiction [to non-Article III tribunals] for the purpose of emasculating constitutional courts, and thereby preventing the encroachment or aggrandizement of one branch at the expense of the other. To the extent that this structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by Article III, § 2. When these Article III limitations are at issue, notions

> of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.

Id. (internal citations and quotation marks omitted).

Along similar lines, the petitioners in *Freytag* specifically consented to the assignment of their case to a special trial judge of the Tax Court. 501 U.S. at 871. On appeal from an adverse decision, the petitioners argued that the appointment of the special trial judge violated the Appointments Clause. *Id.* at 872. The Fifth Circuit refused to consider this argument, concluding that petitioners had waived any constitutional challenge to the appointment of the special trial judge by consenting to a trial before that judge. *Id.*

Notwithstanding this waiver issue, this Court granted certiorari "to resolve the important questions the litigation raise[d] about the Constitution's structural separation of powers." *Id.* at 873. And, despite the petitioners' consent to the trial before the special trial judge, this Court considered the separation-of-powers claim on the merits, explaining that "the disruption to sound appellate process entailed by entertaining objections not raised below does not always overcome what Justice Harlan called 'the strong interest of the federal judiciary in maintaining the constitutional plan of separation of powers.'" *Id.* at 879 (quoting *Glidden Co. v. Zdanok*, 370 U.S. 530, 536 (1962) (plurality op.)); *see also Glidden*, 370 U.S. at 536 (holding that

"the disruption to sound appellate process entailed by entertaining objections not raised below . . . is *plainly insufficient* to overcome the strong interest of the federal judiciary in maintaining the constitutional plan of separation of powers" (emphasis added)). This Court in *Freytag* also gave no deference to the executive branch's assessment that there had been no encroachment by the legislative branch because "[n]either Congress nor the Executive can agree to waive this structural protection. . . . The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic." 501 U.S. at 880.

Additionally, both before and after *Schor*, circuit courts around the country have recognized the distinction between personal rights, which can be waived, and structural separation-of-powers violations, which cannot. *See, e.g.*, *Kuretski v. Comm'r*, 755 F.3d 929, 937-38 (D.C. Cir. 2014) ("Because the Kuretskis raise a structural claim in addition to any 'personal' claim akin to the one asserted in *McElrath*, they did not waive their structural challenge to the Tax Court proceedings by seeking relief in that court."); *Pacemaker Diagnostic Clinic of Am., Inc. v. Instromedix, Inc.*, 725 F.2d 537, 543-44 (9th Cir. 1984) (Kennedy, J.) (en banc) ("The component of the separation of powers rule that protects the integrity of the constitutional structure, as distinct from the component that protects the rights of the litigants, cannot be waived by the parties . . . . On its most fundamental plane, the separation of powers doctrine protects the whole constitutional

structure by requiring that each branch retain its essential powers and independence. Statutes or governmental actions which violate the separation of powers doctrine in its systemic aspect should be invalidated, as a general rule, despite waiver by affected private parties." (citations omitted)).[6]

Therefore, F-Squared's purported waiver cannot shield this structural separation-of-powers claim from judicial inquiry. *See Schor*, 478 U.S. at 837-38; *Kuretski*, 755 F.3d at 937-38. Indeed, by relying on principles of waiver to foreclose judicial review of the SEC's structural separation-of-powers violation, the First Circuit did precisely what *Schor* and its progeny forbid: using concepts of consent or waiver to cure a structural separation-of-powers violation.

The same considerations that were present in *Freytag* and *Schor* warrant the grant of certiorari in this case, which raises an important question concerning the consequences

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[6] *See also United States v. Underwood*, 597 F.3d 661, 672 (5th Cir. 2010) (distinguishing a litigant's "personal right to have an Article III judge conduct [a] plea proceeding," which personal right can be waived, from "Article III structural protections," which "ensure respect for . . . separation-of-powers principles" and "may not be waived"); *Norris v. Schotten*, 146 F.3d 314, 325 (6th Cir. 1998) (explaining that "the structural interest of maintaining an independent judiciary within the constitutional scheme of tripartite government" is not subject to waiver by private litigants); *United States v. Martinez*, 122 F.3d 421, 425 (7th Cir. 1997) ("that part of [the] separation of powers doctrine that protects the integrity of the constitutional structure cannot be waived by the parties").

of the structural separation-of-powers violation that occurs where an agency usurps Congress's core legislative function to create penalties. This usurpation of legislative power by the SEC transcends F-Squared's case and disrupts the constitutional structure of the federal government.

II. The Decision Below is Incompatible with Decisions of this Court which Clearly Establish that a Federal Agency Cannot Confer Power on Itself.

The First Circuit did not address the Trust's voidness argument. That argument, too, presents an important question of federal law. An agency cannot confer power on itself, which is precisely what the SEC did in its settlement with F-Squared. That contracted-for power grab is void, as is the relevant portion of the order that the SEC entered memorializing that void settlement. The Trust is therefore not barred from challenging the void portion of the order.

A. An Agency Cannot Expand its Powers *Sua Sponte* or by Private Agreement, and Any Contract that Purports to do so is Void in Relevant Respects.

"[A]n agency literally has no power to act . . . unless and until Congress confers power upon it." *La. Pub. Serv. Comm'n*, 476 U.S. at 374. It is, therefore, settled that an agency cannot confer power on itself. *See id.* ("[W]e simply cannot accept an argument that [a federal agency] may nevertheless take action which it

thinks will best effectuate a federal policy. An agency may not confer power upon itself. To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress. This we are both unwilling and unable to do.").

In this case, however, the SEC has done just that. It has overridden the clearly expressed will of Congress with respect to its enforcement tools, *see Kokesh*, 137 S. Ct. at 1640, and conferred on itself the legislative power to create an additional, unauthorized penalty. The SEC's attempt to confer power on itself by agreement with F-Squared, therefore, is void. *See La. Pub.* Serv*. Comm'n*, 476 U.S. at 374; *see also Total Med. Mgmt., Inc. v. United States,* 104 F.3d 1314, 1319 (Fed. Cir. 1997) ("A contract [with the government] which is 'plainly illegal' is a nullity and void ab initio . . . . A contract is 'plainly illegal' when made contrary to statute or regulation . . . ." (citation omitted)). Just as the SEC could not insulate itself from public scrutiny by extracting a waiver of a respondent's First Amendment rights through a gag order in a settlement agreement, *see Overbey v. Mayor of Baltimore*, 930 F.3d 215, 222, 224-25 (4th Cir. 2019) (concluding that non-disparagement clause in litigant's settlement with government was unenforceable and void because it amounted to an impermissible waiver of litigant's First Amendment rights), it similarly cannot shield itself from judicial review of the conferral onto itself of the power to collect an additional penalty through a settlement agreement.

B. <u>The Void Order Containing F-Squared's Waiver Cannot Bar Consideration of the Trust's Claims</u>.

Because the SEC's agreement with F-Squared and the order memorializing that agreement are void in relevant part, the Trust's claims are not barred by the waiver contained in that settlement. This Court's decision in *U.S. Fidelity & Guaranty* is instructive in this regard. There, the federal court in the first action issued a money judgment against the United States. 309 U.S. at 510. The United States did not seek review of that judgment, and it became final. *Id.*

In a subsequent case, the United States argued that the prior judgment "was void . . . because the court was 'without jurisdiction to render the judgment.'" *Id.* at 511. The second court rejected that argument, concluding that the United States was barred from collaterally attacking a final judgment. *Id.*

This Court disagreed, holding that "the [first] judgment [was] void in so far as it undertakes to fix a credit against [the United States]" because the United States was protected by sovereign immunity absent congressional authorization for suit against the Government and "[n]o statutory authority granted jurisdiction to the [first] court to adjudicate a cross-claim against the United States." *Id.* at 512.[7]

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[7] Along similar lines, in *Nguyen v. United States*, 539 U.S. 69, 71, 73, 80-81 (2003), this Court vacated decisions of an improperly constituted panel of the Court of Appeals notwithstanding that the petitioners failed to raise the issue until the filing of their petitions for writs of

So too here. Because the SEC could not validly confer authority on itself by agreement with F-Squared, the portion of the order pursuant to which it collected unauthorized disgorgement is void, as is the waiver of judicial review in relevant respects. The Trust's claims,

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certiorari. The appellate panel in *Nguyen* consisted of two Article III judges and one Article IV judge, the Chief Judge of the District Court for the Northern Mariana Islands. *Id.* at 71-72. The appointment of the Article IV judge was unauthorized. *Id.* at 76. Although they did not challenge the composition of the panel at the court-of-appeals level, the petitioners filed petitions for writs of certiorari "raising the question whether the judgment of the Court of Appeals is invalid because of the participation of a non-Article III judge on the panel." *Id.* at 73. In vacating the decisions of the improperly constituted panel, this Court rejected the government's reliance on the petitioners' failure to raise the issue earlier, explaining:

> [T]o ignore the violation of the designation statute in these cases would incorrectly suggest that some action (or inaction) on petitioners' part could create authority Congress has quite carefully withheld. Even if the parties had *expressly* stipulated to the participation of a non-Article III judge in the consideration of their appeals, no matter how distinguished and well qualified the judge might be, such a stipulation would not have cured the plain defect in the composition of the panel.

Id. at 80-81; *see also William Cramp & Sons Ship & Engine Bldg. Co. v. Int'l Curtis Marine Turbine Co.*, 228 U.S. 645, 650 (1913) (granting writ of certiorari and vacating decision of improperly constituted court of appeals notwithstanding that petitioner consented to improper constitution of court of appeals).

therefore, are not barred by F-Squared's waiver of judicial review contained in that void order. *Cf. Sackett v. EPA*, 566 U.S. 120, 131 (2012) (rejecting agency argument that would "enable the strong-arming of regulated parties into 'voluntary compliance' without the opportunity for judicial review").

CONCLUSION

Distilled to its essence, the SEC's position throughout these proceedings is that it has an unreviewable power to do whatever it wants regardless of absence of congressional authorization so long as it can force a potential respondent to agree not to challenge its unlawful actions. This position is fundamentally at odds with the principles on which the federal government is based and has implications that will extend far beyond this case.

By attempting to confer upon itself legislative power to create penalties not given to it by Congress, the SEC committed a structural separation-of-powers violation that can and must be addressed by the judiciary. The prior decisions of this Court demonstrate that the SEC and the First Circuit are wrong in their conclusion that F-Squared validly waived review of the SEC's unlawful usurpation of legislative power of Congress to impose penalties labeled "disgorgement" in administrative proceedings, which are in addition to and in excess of the monetary penalties imposed by the SEC under the applicable penalty provisions. This Court should, therefore, grant this petition for writ of certiorari to review the decision below and

assure that the First Circuit's precedent is consistent with this Court's earlier precedent.

Respectfully submitted,

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May 18, 2020

APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT, DATED DECEMBER 20, 2019

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 18-2043

CRAIG R. JALBERT, in his capacity as Trustee of the F2 Liquidating Trust, on behalf of himself and all others similarly situated,

Plaintiff-Appellant,

v.

U.S. SECURITIES AND EXCHANGE COMMISSION,

Defendant-Appellee.

December 20, 2019, Decided

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS

(Hon. F. Dennis Saylor IV, *U.S. District Judge*)

Before
Torruella, Thompson, and Kayatta,
Circuit Judges.

TORRUELLA, Circuit Judge. Plaintiff-appellant Craig R. Jalbert ("Jalbert"), in his capacity as trustee for the F2 Liquidating Trust, appeals the district court's order granting the Securities and Exchange Commission's ("SEC") motion to dismiss his complaint for lack of subject matter jurisdiction and failure to state a claim. The district court determined that the right to judicial review of the SEC order at issue had been waived as part of a settlement between the SEC and former investment advisory firm F-Squared Investments, Inc. ("F-Squared"). The district court also held that, in any event, Jalbert's claims were only reviewable within the SEC's exclusive statutory review structure, which does not involve the federal district courts. After careful consideration, we affirm on the ground that F-Squared failed to state a claim upon which relief could be granted inasmuch as it waived judicial review by any court.

I. Background

A. Factual Background

F-Squared was an SEC-registered investment adviser firm headquartered in Wellesley, Massachusetts. It served clients in the advisor, institutional, retail, and retirement markets. At some unspecified point, the SEC began investigating F-Squared for violations of federal securities laws.

On December 4, 2014, with the threat of administrative and cease-and-desist proceedings looming, F-Squared executed an Offer of Settlement pursuant to Rule 240(a) of

the Rules of Practice of the SEC, 17 C.F.R. § 201.240(a) (the "Offer"). The Offer included the following language: "By submitting this Offer, Respondent hereby acknowledges its waiver of those rights specified in Rules 240(c)(4) and (5) [17 C.F.R. § 201.240(c)(4) and (5)] of the Commission's Rules of Practice." Rule 240(c)(4) provides, as relevant to this appeal, that "[b]y submitting an offer of settlement, the person making the offer waives, subject to acceptance of the offer . . . [j]udicial review by any court." 17 C.F.R. § 201.240(c)(4).

The SEC accepted the Offer and settled with F-Squared on December 22, 2014, through the entry of an "Order Instituting Administrative and Cease-and-Desist Proceedings" (the "Order"), to which F-Squared consented. Under the terms of the Order, F-Squared admitted that, between April 2001 and September 2008, advertising materials for one of its investment strategies included statements based on the inaccurate compilation of performance and historical data which improved and inflated the strategy's historical performance. That conduct, F-Squared accepted, violated federal securities laws. F-Squared agreed to cease and desist from committing further securities-laws violations and to undertake certain compliance measures. The Order also required F-Squared to pay $30 million in disgorgement and a $5 million civil money penalty to the United States Treasury. As agreed, F-Squared transferred $35 million directly into the Treasury.

In July 2015, F-Squared filed for bankruptcy. The F2 Liquidating Trust was established during the bankruptcy

proceedings to recover on behalf of F-Squared as its successor-in-interest. The bankruptcy court appointed Jalbert as the trustee.

B. Procedural History

On October 26, 2017, Jalbert filed a complaint in the U.S. District Court for the District of Massachusetts against the SEC purporting to represent the F2 Liquidating Trust and "all other individuals and entities similarly situated" who had "money collected from them by the SEC as 'disgorgement' without statutory authority or in excess of statutory authority" during the six years prior to the filing of the complaint. Jalbert asserted two claims under the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551 *et seq.*, alleging that: (1) in light of the then-recent Supreme Court opinion in *Kokesh v. SEC*, 137 S. Ct. 1635, 198 L. Ed. 2d 86 (2017),[1] the SEC

1. *Kokesh* held that, in the securities-enforcement context, disgorgement is a penalty within the meaning of the five-year limitations period under 28 U.S.C. § 2462 where it is ordered to punish and deter violations of securities laws and is paid directly to the United States Treasury. 137 S. Ct. at 1639, 1643-44. The Court concluded, therefore, that disgorgement actions must be commenced within five years of the claim's accrual. *Id.* at 1639. The *Kokesh* Court, however, pointed out that its decision was narrow, for purposes of only the statute of limitations, and was not meant to undermine disgorgement in SEC enforcement actions in federal court. *See id.* at 1642 n.3 ("Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context[.] The sole question presented in this case is whether disgorgement, as applied in SEC

"exceeded its statutory authority by seeking and obtaining disgorgement from F-Squared and the similarly situated members of the Proposed Class as a separate monetary penalty" in both administrative proceedings and federal court actions and (2) the SEC "failed to observe the procedural requirements" of federal securities law by not obtaining an accounting of profits allegedly acquired as a result of wrongdoing before ordering disgorgement. The complaint sought a declaration that the SEC's collection of disgorgement was unlawful pursuant to 5 U.S.C. § 706; the setting aside of the $30 million disgorgement paid by F-Squared under the Order; and a refund of that payment, as well as similar refunds for the putative class members.

On April 4, 2018, the SEC filed a motion to dismiss the complaint pursuant to Federal Rules of Civil Procedure 12(b)(1) and (6). On August 22, 2018, the district court entered a memorandum and order granting the SEC's motion to dismiss. *Jalbert v. SEC*, 327 F. Supp. 3d 287 (D. Mass. 2018). The court determined that it lacked subject matter jurisdiction because Congress vested the courts of appeals with exclusive jurisdiction over challenges to SEC orders. *Id.* at 296-97, 299-300. It also held that Jalbert had failed to state a claim upon which relief could be granted because "F-Squared, as part of the settlement, clearly and unambiguously waived the right to judicial review by any

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enforcement actions, is subject to § 2462's limitations period."). We note that the Supreme Court recently granted certiorari in a case which presents the question that was expressly avoided in footnote 3 of *Kokesh. See SEC v. Liu*, 754 F. App'x 505 (9th Cir. 2018), *cert. granted*, 140 S. Ct. 451, 205 L. Ed. 2d 265, 2019 WL 5659111 (U.S. Nov. 1, 2019) (No. 18-1501).

court." *Id.* at 295. Jalbert then filed this timely appeal of the district court's dismissal.

II. Discussion

We review a district court's dismissal for lack of subject matter jurisdiction and for failure to state a claim *de novo*, construing the complaint "liberally" and treating "all well-pleaded facts as true." *Aurelius Capital Master, Ltd. v. Commonwealth of P.R. (In re Fin. Oversight & Mgmt. Bd. for P.R.)*, 919 F.3d 638, 644 (1st Cir. 2019) (quoting *Town of Barnstable v. O'Connor*, 786 F.3d 130, 138 (1st Cir. 2015), and citing *Newman v. Lehman Bros. Holdings Inc.*, 901 F.3d 19, 24 (1st Cir. 2018)). We accord Jalbert "the benefit of all reasonable inferences." *Town of Barnstable*, 786 F.3d at 138 (quoting *Murphy v. United States*, 45 F.3d 520, 522 (1st Cir. 1995)). Nevertheless, the complaint must allege "a plausible entitlement to relief." *Decotiis v. Whittemore*, 635 F.3d 22, 29 (1st Cir. 2011) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 559, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007)).

Jalbert's big-ticket argument is that in light of the Supreme Court's decision in *Kokesh* — which holds that disgorgement ordered in civil enforcement proceedings constitutes a "penalty" subject to the five-year statute of limitations set forth in 28 U.S.C. § 2462,[2] 137 S. Ct. at

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2. That statute provides, "[e]xcept as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ." 28 U.S.C. § 2462.

1639 — the SEC's $30 million disgorgement order against F-Squared was unauthorized under the statutes governing SEC disgorgement because it was a penalty and not a remedial, compensatory charge. Jalbert contends that the SEC intended F-Squared's disgorgement as a penalty because, like in *Kokesh*, it was ordered to punish and deter conduct, and the proceeds were paid directly into the Treasury rather than returned to the injured investors. But as the district court correctly concluded, we do not need to delve into the merits of these arguments because they are not properly before us.

The SEC's Rules of Practice allow "[a]ny person who is notified that a proceeding may or will be instituted against him or her, or any party to a proceeding already instituted [to] propose in writing an offer of settlement." 17 C.F.R. § 201.240(a). The Rules also require an offer of settlement to "recite or incorporate as a part of the offer the provisions of paragraphs (c)(4) and (5) of this section," 17 C.F.R. § 201.240(b), which, as relevant to this appeal, include the waiver, subject to the acceptance of the offer, of "[j]udicial review by any court," § 201.240(c)(4)(v).

F-Squared voluntarily executed such an offer to settle with the SEC. In compliance with 17 C.F.R. § 201.240(b), the Offer included an acknowledgement of F-Squared's "waiver of those rights specified in Rules 240(c)(4) and (5) [17 C.F.R. § 201.240(c)(4) and (5)] of the Commission's Rules of Practice." Thus, as part of the Offer, F-Squared knowingly and voluntarily agreed to waive judicial review of the ensuing order if the SEC accepted it. In due course, the SEC accepted the Offer in its December 22, 2014

Order. *See* 17 C.F.R. § 201.240(c)(7) ("Final acceptance of any offer of settlement will occur only upon the issuance of findings and an order by the Commission."). Accordingly, the district court properly determined that F-Squared's "clear[] and unambiguous[]" waiver barred the court's consideration of Jalbert's claims on the merits. *Jalbert*, 327 F. Supp. 3d at 295. While Jalbert posits several arguments to the contrary on appeal, none are persuasive.

First, Jalbert argues that the SEC's "longstanding practice of obtaining additional, extra-statutory penalties" disguised as "disgorgement" constitutes a structural separation-of-powers violation that cannot be waived. Relying on *Kokesh*, Jalbert's argument assumes that the SEC exceeded its statutory authority in ordering disgorgement that is, according to Jalbert, punitive and unauthorized, which alone is enough to implicate separation-of-powers principles. But the *Kokesh* Court explicitly stated that "[n]othing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context," and it limited its holding to the applicability of the five-year limitations period under 28 U.S.C. § 2462 to the SEC's requests for disgorgement. *Kokesh*, 137 S. Ct. at 1642 n.3; *see also id.* at 1640-41. Indeed, with the enactment of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931, Congress explicitly authorized the SEC to enter orders requiring "accounting and disgorgement" in administrative and cease-and-desist proceedings. *See* 15 U.S.C. §§ 77h-1(e), 78u-3(e), 80a-9(e)

and (f)(5), 80b-3(j) and (k)(5); *see also* S. Rep. No. 101-337, at 8, 16 (1990) ("The legislation authorizes the SEC to seek civil money penalties in court proceedings and to impose penalties and order disgorgement in administrative proceedings for violations of the federal securities laws. . . . The Committee believes . . . that the SEC should have the express authority to order disgorgement in its administrative proceedings in order to ensure that respondents in administrative proceedings do not retain ill-gotten gains."). Notably, *Kokesh* does not even mention the application of disgorgement in the context of administrative or cease-and-desist proceedings. Instead, it addresses disgorgement solely in the civil enforcement context within the meaning of section 2462. *Kokesh*, 137 S. Ct. at 1639. Thus, the SEC's statutory authority to request disgorgement in administrative proceedings is seemingly undisturbed by *Kokesh*.

Jalbert does not challenge the statutes granting that authority. Rather, Jalbert's structural separation-of-powers argument is based on his contention that the SEC's disgorgement practices exceed the bounds of the SEC's statutory authority. But this argument does not implicate a structural separation-of-powers issue. We have held that "the doctrine of separated powers serves to eliminate arrangements that threaten to permit one branch either to aggrandize its power or to encroach on functions reserved for another branch." *United States v. Hilario*, 218 F.3d 19, 26 (1st Cir. 2000) (citing *Mistretta v. United States*, 488 U.S. 361, 381-82, 109 S. Ct. 647, 102 L. Ed. 2d 714 (1989)). "Separation-of-powers principles are intended, in part, to protect each branch of government from incursion by the

others." *Bond v. United States*, 564 U.S. 211, 222, 131 S. Ct. 2355, 180 L. Ed. 2d 269 (2011). Even if Jalbert were correct that the SEC acted beyond its statutory powers in interpreting the accounting and disgorgement provision and seeking disgorgement in a "punitive fashion," this is not a case in which the "usurp[ation of] the prerogatives of another branch of government" would be implicated. *Hilario*, 218 F.3d at 27. Further, there is no "accret[ion] to a single [b]ranch [of] powers more appropriately diffused among separate [b]ranches," nor has the "authority and independence" of the other branches been undermined. *Mistretta*, 488 U.S. at 382; *see also Hilario*, 218 F.3d at 26.[3]

As the district court noted, Jalbert's claim that the SEC was acting outside the scope of its statutory authority is, at best, viewed as an assertion that the SEC was acting ultra vires. *See Jalbert*, 327 F. Supp. 3d at 296. But even if this were true, that claim was waivable. We agree with the district court's reliance on *City of Arlington v. FCC*, 569 U.S. 290, 133 S. Ct. 1863, 185 L. Ed. 2d 941 (2013), to support its conclusion that ultra vires claims of error can be waived. *See Jalbert*, 327 F. Supp. 3d at 296. In *City of Arlington*, the Supreme Court rejected as merely "illusory" the distinction, for *Chevron* purposes, between "jurisdictional" and "nonjurisdictional" agency interpretations and errors. 569 U.S. at 298. The Supreme

3. Jalbert also takes issue with the cases upon which the district court relied in concluding that F-Squared's waiver was effective because, according to Jalbert, none involved structural separation-of-powers violations. But because we have determined that Jalbert's claim is not one of structural separation-of-powers violations, we do not address this point any further.

Court also defined any "improper" agency action as "ultra vires". *Id.* at 297-98. In doing so, it reasoned that

> A court's power to decide a case is independent of whether its decision is correct . . . . Put differently, a jurisdictionally proper but substantively incorrect judicial decision is not ultra vires. That is not so for agencies charged with administering congressional statutes. Both their power to act and how they are to act is authoritatively prescribed by Congress, so that when they act improperly, no less than when they act beyond their jurisdiction, what they do is ultra vires. Because the question — whether framed as an incorrect application of agency authority or an assertion of authority not conferred — is always whether the agency has gone beyond what Congress has permitted it to do, there is no principled basis for carving out some arbitrary subset of such claims as "jurisdictional."

Id. Therefore, if the SEC was acting unlawfully in seeking the $30 million disgorgement from F-Squared, its actions were no more ultra vires than if the SEC had misinterpreted its statutes. And statutory construction claims are largely subject to waiver. *See Boston Redevelopment Auth. v. Nat'l Park Serv.*, 838 F.3d 42, 47-50 (1st Cir. 2016) (finding waiver of challenge to the National Park Service's construction of the Land and Water Conservation Fund Act); *see also Nat. Res. Def. Council, Inc. v. EPA*, 25 F.3d 1063, 1073-74, 306 U.S. App.

D.C. 357 (D.C. Cir. 1994) (finding waiver of statutory and regulatory construction challenge). Moreover, generally, while jurisdictional issues can be raised at any time during the case and are never waived, non-jurisdictional issues are waivable. *See Gonzalez v. Thaler*, 565 U.S. 134, 141, 132 S. Ct. 641, 181 L. Ed. 2d 619 (2012); *see also Wolf v. Reliance Standard Life Ins. Co.*, 71 F.3d 444, 446, 449 (1st Cir. 1995).

The Supreme Court's analysis in *City of Arlington* leads us to conclude that challenges to ultra vires agency action are waivable. Our conclusion comports with other circuits' decisions. *See PGS Geophysical AS v. Iancu*, 891 F.3d 1354, 1362 (Fed. Cir. 2018) ("Even if the [Patent Trial and Appeal Board of the U.S. Patent and Trademark Office] could be said to have acted 'ultra vires' in refusing to institute reviews of some claims and grounds — and then proceeding to merits decisions concerning the claims and grounds included in the instituted reviews — the Board's error is waivable . . . ."); *Metro-North Commuter R.R. Co. v. U.S. Dep't of Labor*, 886 F.3d 97, 108 (2d Cir. 2018) (relying on the Supreme Court's decision in *City of Arlington* to find that challenges to an agency's jurisdiction over certain claims can be waived); *1621 Route 22 W. Operating Co. v. NLRB*, 825 F.3d 128, 139-42 (3d Cir. 2016) (finding the challenge to an agency's jurisdiction was waived); *CBS Broad., Inc. v. EchoStar Commc'ns Corp.*, 450 F.3d 505, 520 n.27 (11th Cir. 2006) (finding the argument that the FCC acted beyond the scope of its authority and, thus, that its action was ultra vires, to be waived); *see also Boston Redevelopment Auth.*, 838 F.3d at 47 (finding the argument waived that because agency

action was ultra vires the agency's determination should be reviewed *de novo*).

Faced with, at most, a claim alleging that the SEC exceeded its jurisdictional authority and acted ultra vires in seeking disgorgement, the district court correctly concluded that the claim was waivable and that F-Squared had undeniably waived the right to assert the claim by settling with the SEC.

Next, Jalbert avers that the waiver does not reach his APA claims because he is not seeking review of the Order and does not intend to "disturb the merits of the SEC's substantive decision" regarding F-Squared's securities laws violations and the amount of the civil penalty. Instead, he contends that he is simply seeking a declaration that the SEC lacks the power to enter disgorgement orders, and consequently, the disgorgement against F-Squared is void.

Contrary to Jalbert's contention, by challenging the validity of the disgorgement, he is challenging the Order itself because it was through that Order (to which F-Squared consented) that the SEC directed F-Squared to pay a disgorgement of $30 million into the Treasury. Furthermore, the plain text of the waiver states that it applies to "[j]udicial review by any court." *See* 17 C.F.R. § 201.240(c)(4)(v). This language is broad enough to encompass claims under the APA because those entail judicial review of an agency decision, *see* 5 U.S.C. § 706(2)(A)-(F) (providing bases for a reviewing court to "hold unlawful and set aside agency action, findings, and conclusions"), even if Jalbert does not challenge the

substantive findings of the Order. When F-Squared chose to settle and execute the Offer, it decided to waive all judicial review by any court without qualification.

Relatedly, Jalbert posits that his challenge to the SEC's disgorgement practices is not limited to F-Squared's disgorgement order but includes a challenge to the SEC's "longstanding practice and procedure of obtaining disgorgement in an unauthorized punitive fashion in a host of cases" on behalf of a putative class of similarly situated parties. This argument, too, is unavailing.

We have noted that "in most respects, the class members other than the named plaintiffs are merely potential parties until subject matter jurisdiction for the named plaintiffs is established and the district court has decided to certify a class." *Pruell v. Caritas Christi*, 645 F.3d 81, 84 (1st Cir. 2011). When a class action is filed, it "includes only the claims of the named plaintiff or plaintiffs. The claims of unnamed class members are added to the action later, when the action is certified as a class under [Federal Rule of Civil Procedure] 23." *Id.* (quoting *Gibson v. Chrysler Corp.*, 261 F.3d 927, 940 (9th Cir. 2001)). Here, the district court did not certify a class. It merely determined that it lacked subject matter jurisdiction. Thus, the purported existence of those claims by "similarly situated parties" was irrelevant to the district court's decision to dismiss the case. It is also hard to see how, for the putative class's claim, Jalbert could meet the injury-in-fact requirement of Article III, which requires a plaintiff to establish an injury that is "concrete and particularized" and "actual or imminent,

not 'conjectural' or 'hypothetical.'" *Reddy v. Foster*, 845 F.3d 493, 500 (1st Cir. 2017) (quoting *Susan B. Anthony List v. Driehaus*, 573 U.S. 149, 158, 134 S. Ct. 2334, 189 L. Ed. 2d 246 (2014)); *see Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1545, 194 L. Ed. 2d 635 (2016) ("[T]he injury-in-fact requirement [of Article III] requires a plaintiff to allege an injury that is both 'concrete *and* particularized.'" (emphasis in original) (quoting *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 180-81, 120 S. Ct. 693, 145 L. Ed. 2d 610 (2000))); *see also Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 40 n.20, 96 S. Ct. 1917, 48 L. Ed. 2d 450 (1976) ("[E]ven named plaintiffs who represent a class 'must allege and show that they personally have been injured, not that injury has been suffered by other, unidentified members of the class to which they belong and which they purport to represent.'" (quoting *Warth v. Seldin*, 422 U.S. 490, 502, 95 S. Ct. 2197, 45 L. Ed. 2d 343 (1975))).

Next, Jalbert takes aim at the SEC's use of Rule 240 — which requires the waiver of judicial review as a condition of settlement — arguing that it cannot overcome the presumption that SEC actions are judicially reviewable under the APA. He contends that the incorporation of Rule 240 into SEC orders is unlawful because the SEC may not "contract out" of APA review.

To begin, nothing in the record suggests that the purpose or aim of Rule 240 is to overcome the presumption of reviewability of SEC actions under the APA. Surely, before entering into the settlement with the SEC, F-Squared knew or should have known there were avenues,

both direct and collateral, to obtain judicial review of an SEC order. Indeed, F-Squared expressly acknowledged in its Offer that it was waiving certain procedural rights. *See* 17 C.F.R. § 201.240(c)(4)-(5). F-Squared knowingly and voluntarily chose to enter into an early settlement and waive judicial review rather than partake in public administrative and cease-and-desist proceedings. We have found that settlements are strongly encouraged by public policy, especially, where "a government actor committed to the protection of the public interest has pulled the laboring oar in constructing the proposed settlement." *United States v. Cannons Eng'g Corp.*, 899 F.2d 79, 84 (1st Cir. 1990) (citing *FTC v. Standard Fin. Mgmt. Corp.*, 830 F.2d 404, 408 (1st Cir. 1987)).

Moreover, the APA itself requires an agency to give parties opportunity for "the submission and consideration of . . . offers of settlement." 5 U.S.C. § 554(c)(1). The Senate Report accompanying this provision states that "[t]he settlement by consent provision is extremely important because agencies ought not to engage in formal proceedings where the parties are perfectly willing to consent to judgments or adjust situations informally." S. Doc. No. 79-248, at 361 (1946). We note that other agencies have similar regulations requiring the waiver of judicial review as a condition of settling an action with the agency. *See, e.g.*, 16 C.F.R. § 2.32 (FTC regulation requiring that "[e]very agreement [in settlement of an FTC complaint] waive further procedural steps and all rights to seek judicial review or otherwise to challenge or contest the validity of the order"); 47 C.F.R. § 1.94(c)(3) (FCC regulation requiring "[a] waiver of the right of

judicial review or otherwise to challenge or contest the validity of the consent order" to be included in settlement agreements); 49 C.F.R. § 511.26(d)(2) (DOT regulation requiring an offer of settlement to contain "[a]n express waiver of further procedural steps, and of all rights to seek judicial review or otherwise to contest the validity of the order"). And Jalbert cites no authority for upending a waiver of judicial review contained in a settlement with a governmental agency.

In his final attempt to dodge the waiver, Jalbert invokes contract principles to allege that the waiver is unenforceable because the agreement was infected with a mutual mistake of law. Specifically, Jalbert avers that both the SEC and F-Squared believed the SEC had the authority to obtain the $30 million disgorgement from F-Squared, and that it was not until the Supreme Court's decision in *Kokesh* that F-Squared realized the mistake. This argument, again, assumes that *Kokesh* changed the law on SEC disgorgement despite its explicit, narrow holding. And even taking as true Jalbert's assertion that *Kokesh* changed the law since F-Squared and the SEC settled, that case is silent about agreed-upon disgorgement orders, a product of parties' agreements to settle impending administrative proceedings, like the disgorgement here.

In any event, under Massachusetts law, "a party cannot avoid a contract merely because the parties are mistaken as to an assumption, even though significant, on which the contract was made." *Shawmut-Canton LLC v. Great Spring Waters of Am., Inc.*, 62 Mass. App. Ct.

330, 816 N.E.2d 545, 550-51 (Mass. App. Ct. 2004) (citing Restatement (Second) of Contracts § 152 cmt. c (1981)). "Relief is only appropriate in situations where a mistake of both parties has such a material effect on the agreed exchange of performances as to upset the very basis for the contract." *Id.* at 551 (quoting Restatement (Second) of Contracts § 152 cmt. a). Moreover, the mistake must be based on a fact "capable of ascertainment at the time" the parties entered the contract.[4] *LaFleur v. C.C. Pierce Co.*, 398 Mass. 254, 496 N.E.2d 827, 830 (Mass. 1986); *Cook v. Kelley*, 352 Mass. 628, 227 N.E.2d 330, 333 (Mass. 1967). Here, the purported change in law was not "capable of ascertainment" when F-Squared and the SEC entered into the settlement. By Jalbert's own concession, the law was "so well established at the time of the settlement," that "the parties were not settling because of any uncertainty about the SEC's statutory authority to obtain disgorgement. Instead, the parties settled over the issue of whether there had been a violation of the securities laws." Thus, Jalbert cannot escape the final settlement that F-Squared willingly entered into in 2014 for reasons completely collateral to a then-unforeseeable Supreme Court decision that was handed down nearly three years later to have a second bite of the apple in an attempt to obtain a refund of $30 million.[5]

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4. The Restatement (Second) of Contracts clarifies that it does not "draw the distinction that is sometimes made between 'fact' and 'law.'" Restatement (Second) of Contracts § 151 cmt. b. Rather, it "treat[s] the law in existence at the time of the making of the contract as part of the total state of facts at that time." *Id.*

5. We should also note that Jalbert's request that a party to a final and binding settlement agreement should be allowed to back-

Unconvinced by Jalbert's arguments that the voluntary, express waiver of judicial review in the Order is void or ineffective, we conclude that the district court correctly decided that the complaint failed to state a claim upon which relief could be granted inasmuch as F-Squared waived judicial review by any court. Having decided that Jalbert's claims are not entitled to judicial review, it is unnecessary to address Jalbert's remaining arguments, and our conclusion is sufficient to dispose of this appeal.

III. Conclusion

For the foregoing reasons, we affirm the district court's order.

Affirmed.

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pedal when purportedly more favorable law emerges several years later does not comport with this Court's policy favoring settlement "as a preferred alternative to costly, time-consuming litigation." *Fid. & Guar. Ins. Co. v. Star Equip. Corp.*, 541 F.3d 1, 5 (1st Cir. 2008) (quoting *Mathewson Corp. v. Allied Marine Indus., Inc.*, 827 F.2d 850, 852 (1st Cir. 1987)). *See also Mathewson Corp.*, 827 F.2d at 852 ("We have characterized a settlement negotiated, as here, 'under the eyes of the court [as] a most solemn undertaking.'" (alteration in original) (quoting *Warner v. Rossignol*, 513 F.2d 678, 682 (1st Cir. 1975))); *id.* at 852-53 (finding that we "will enforce the [settlement] without regard to what the result might have been had the parties chosen to litigate" (quoting *Terrain Enters., Inc. v. W. Cas. & Sur. Co.*, 774 F.2d 1320, 1321 (5th Cir. 1985))).

APPENDIX B — MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS, FILED AUGUST 22, 2018

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

Civil Action
No. 17-12103-FDS

CRAIG R. JALBERT, IN HIS CAPACITY AS TRUSTEE OF THE F2 LIQUIDATING TRUST, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED,

Plaintiff,

v.

SECURITIES AND EXCHANGE COMMISSION,

Defendant.

August 22, 2018, Decided;
August 22, 2018, Filed

MEMORANDUM AND ORDER ON DEFENDANT'S MOTION TO DISMISS

SAYLOR, J.

This is a suit by a bankruptcy trustee challenging the authority of the Securities and Exchange Commission

to order disgorgement as part of a settlement of an administrative proceeding. The settlement in question occurred in 2014. The trustee filed suit three years later, seeking to invalidate that settlement, on the ground that the disgorgement was unlawful.

F-Squared Investments, Inc., a Massachusetts-based registered investment adviser, was charged in an SEC administrative proceeding with using materially false marketing materials. In December 2014, it entered into a settlement with the SEC. As part of that settlement, it agreed to pay disgorgement of $30 million and a civil money penalty of $5 million. In addition, it expressly agreed to waive "judicial review" of that settlement by "any court."

In 2015, F-Squared filed for bankruptcy, and Craig Jalbert was appointed as trustee of plaintiff F2 Liquidating Trust, the successor-in-interest to F-Squared.

The trustee now challenges that settlement, contending that the disgorgement portion of the order was unlawful in light of the Supreme Court's opinion in *Kokesh v. SEC*, 137 S. Ct. 1635, 198 L. Ed. 2d 86 (2017). The SEC has moved to dismiss the complaint for lack of subject-matter jurisdiction and failure to state a claim. For the following reasons, the motion to dismiss will be granted.

I. Background

A. Factual Background

The facts are set forth as described in the complaint, attached exhibits, and public record.

1. F-Squared's Securities Violations

F-Squared Investments, Inc. was a Wellesley-based investment adviser. (Compl. Ex. A ¶ 5). It was founded by Howard Present in 2006. (*Id.* ¶ 6). It launched its first "AlphaSector" index in October 2008. (*Id.* ¶ 5). The "AlphaSector" investment strategy was an exchange-traded fund ("ETF") sector rotation strategy. (*Id.* ¶ 1).[1] F-Squared would apply ETF trend data to determine whether a particular ETF was in or out of the AlphaSector portfolio. (*Id.* ¶ 2).

Between October 2008 and September 2013, F-Squared marketed the AlphaSector strategy. (*Id.* ¶ 7). F-Squared's marketing materials included inaccurate statements portraying AlphaSector indices as actual performance in

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1. An ETF typically owns shares of stock that closely track an underlying index. For example, the popular ETF SPDR tracks the S&P 500, a leading index that is based on the market capitalization of the 500 largest companies trading on the NYSE or NASDAQ. However, unlike mutual funds, ETFs are traded in the same manner as common stock on exchanges and are accordingly more liquid.

Sector rotation entails moving funds from one industry sector to another in an attempt to outperform the market.

the period from April 2001 to September 2008. (*Id.* ¶ 29). Specifically, F-Squared claimed the strategy was "not back[-]tested," when in fact it was. (*Id.* ¶¶ 1, 7 n.3).[2] In addition, F-Squared incorrectly applied ETF trend data such that the AlphaSector strategy implemented buy and sell signals one week before the price shifts creating the signals actually occurred. (*Id.* ¶¶ 2-3).[3]

By June 30, 2014, approximately $28.5 billion had been invested pursuant to 75 AlphaSector indices. (*Id.* ¶ 7 n.3). $13 billion of that amount was in mutual-fund assets sub-advised by F-Squared. (*Id.* ¶ 5).[4] Most of the assets invested pursuant to AlphaSector indices were invested through registered mutual funds, other funds, or separately managed accounts managed by advisers or brokers who received information from F-Squared. (*Id.* ¶ 7).

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2. "Back-testing" involves applying an investment strategy to past market conditions to show how the strategy could have performed had it been used then. However, because it does not portray actual performance, the SEC has restricted its use in advertising.

3. An investment of $100,000 in the S&P 500 on April 1, 2001, would have been worth $128,000 on August 24, 2008, a 28% increase. Using an accurately timed, but still back-tested, AlphaSector strategy, the investment would have been worth $138,000 on August 24, 2008, a 38% increase. Using the inaccurately timed and backtested AlphaSector strategy, which was the one actually advertised, the investment would have been worth $235,000 on August 24, 2008, a 135% increase. (Compl. Ex. A ¶ 3).

4. A fund subadvisor is a third party hired by the fund adviser to help manage a portion of the investment portfolio.

2. <u>The Settlement with the SEC</u>

At some point, the SEC began investigating whether F-Squared had violated federal securities laws. In December 2014, F-Squared and the SEC entered into a settlement in order to resolve the matter. The settlement involved an administrative proceeding, not a civil enforcement action.

The settlement took the form of an "Offer of Settlement of F-Squared Investments, Inc." that was accepted by the SEC, although presumably the terms were negotiated in advance. The settlement agreement indicated that F-Squared "submits this Offer of Settlement . . . in anticipation of public administrative and cease-and-desist proceedings to be instituted against it by the [SEC]" pursuant to the Investment Advisers Act of 1940 and the Investment Company Act of 1940. (Def. Ex. 1 § I).

Among other things, F-Squared admitted to certain facts; acknowledged that its conduct violated the federal securities laws; and admitted that the SEC had jurisdiction over it and over the matters at issue. (*Id.* § VII). F-Squared also "consent[ed] to the entry of the attached Order by Commission, in which the Commission" (1) found that F-Squared willfully violated §§ 204, 206, and 207 of the Investment Advisers Act and various rules promulgated under that act, and aided and abetted a violation of § 34(b) of the Investment Company Act; (2) ordered that F-Squared cease and desist from committing any future violations; (3) ordered that F-Squared "pay disgorgement of [$30 million] to the United States Treasury"; (4) ordered that it pay a "civil money penalty" of $5 million to the

Treasury; and (5) ordered that it comply with certain undertakings, largely relating to compliance. (*Id.*).

> The "Offer of Settlement" also included the following language:
>
> By submitting this Offer, Respondent hereby acknowledges its waiver of those rights specified in Rules 240(c)(4) and (5) [17 C.F.R. 201.240(c)(4) and (5)] of the Commission's Rules of Practice.

(*Id.* § V). Rule 240(c)(4) provides as follows:

> (4) By submitting an offer of settlement, the person making the offer waives, subject to acceptance of the offer:
>
> > (i) All hearings pursuant to the statutory provisions under which the proceeding is to be or has been instituted;
> >
> > (ii) The filing of proposed findings of fact and conclusions of law;
> >
> > (iii) Proceedings before, and an initial decision by, a hearing officer;
> >
> > (iv) All post-hearing procedures; and
> >
> > (v) *Judicial review by any court*.

17 C.F.R. 201.240(c)(4) (emphasis added).

F-Squared then transferred $35 million to the Treasury Department. (Compl. ¶ 59). No portion of that money was paid to the present or former clients of F-Squared. (*Id.*).

3. Later Developments

On July 8, 2015, F-Squared filed for bankruptcy. (*Id.* ¶ 60). Craig Jalbert was appointed by the bankruptcy court as trustee of the F2 Liquidating Trust, F-Squared's successor-in-interest. (*Id.* ¶ 11).

On June 5, 2017, the Supreme Court issued its opinion in *Kokesh*, described in greater detail below.

B. Procedural Background

The trustee filed this complaint on October 26, 2017. He seeks to represent a class of all securities-law violators who have paid disgorgement to the SEC over the past six years. The complaint does not distinguish between disgorgement orders in administrative or judicial proceedings. It asserts two counts, both brought under the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 701-06. Count 1 is a claim that the SEC "exceeded its statutory authority by obtaining 'disgorgement'" in enforcement actions. Count 2 is a claim that the SEC failed to comply with the procedural requirements of federal securities laws by failing to obtain an accounting of profits before ordering disgorgement.

The SEC has moved to dismiss the complaint for lack of subject-matter jurisdiction pursuant to Fed. R. Civ. P.

12(b)(1) and failure to state a claim pursuant to Fed. R. Civ. P. 12(b)(6).

II. Legal Standard

On a motion to dismiss, the court "must assume the truth of all well-plead[ed] facts and give . . . plaintiff the benefit of all reasonable inferences therefrom." *Ruiz v. Bally Total Fitness Holding Corp.*, 496 F.3d 1, 5 (1st Cir. 2007) (citing *Rogan v. Menino*, 175 F.3d 75, 77 (1st Cir. 1999)). To survive a motion to dismiss, the complaint must state a claim that is plausible on its face. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007). In other words, the "[f]actual allegations must be enough to raise a right to relief above the speculative level, . . . on the assumption that all the allegations in the complaint are true (even if doubtful in fact)." *Id.* at 555 (citations omitted). "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009) (quoting *Twombly*, 550 U.S. at 556). Dismissal is appropriate if the complaint fails to set forth "factual allegations, either direct or inferential, respecting each material element necessary to sustain recovery under some actionable legal theory." *Gagliardi v. Sullivan*, 513 F.3d 301, 305 (1st Cir. 2008) (quoting *Centro Medico del Turabo, Inc. v. Feliciano de Melecio*, 406 F.3d 1, 6 (1st Cir. 2005)).

III. <u>Analysis</u>

The trustee contends that in light of the Supreme Court's decision in *Kokesh*, which was issued in 2017, the $30 million disgorgement paid to the SEC as part of the 2015 settlement is invalid. The trustee has multiple hurdles to overcome to establish such a claim. First, and as set forth below, the SEC has explicit statutory authority to enter disgorgement orders in administrative proceedings. Thus, the settlement is valid unless the SEC's exercise of its statutory authority to obtain disgorgement was somehow illegal. Second, and as noted above, F-Squared entered into a binding settlement with the SEC in which it expressly waived judicial review. Therefore, the Court may consider the trustee's claims only if that waiver is somehow void or otherwise ineffective. Third, Congress has created a process for judicial review of SEC orders in administrative proceedings, and that process does not involve the federal district courts. Accordingly, this Court has subject-matter jurisdiction over the trustee's claims only if that statutory scheme is somehow inapplicable.

A. <u>The Supreme Court's Decision in *Kokesh*</u>

Following the stock market crash in 1929, Congress enacted a series of laws to regulate the securities industry. Among other things, the Securities Exchange Act of 1934 ("Exchange Act") created the SEC to enforce federal securities laws. "Congress granted the [SEC] power to prescribe 'rules and regulations . . . as necessary or appropriate in the public interest or for the protection of investors." *Kokesh*, 137 S. Ct. at 1640 (quoting *Blue Chip*

Stamps v. Manor Drug Stores, 421 U.S. 723, 728, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975)).

"Initially, the only statutory remedy available to the SEC in an enforcement action was an injunction barring future violations of securities laws." *Id.* Despite a lack of explicit statutory authority, beginning in the 1970s, courts began to order disgorgement in SEC civil enforcement suits as an exercise of their equitable powers to "deprive . . . defendants of their profits in order to remove any monetary reward for violating securities laws." *Id.* (quoting *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 92 (S.D.N.Y. 1970)).[5]

In 1990, as part of the Penny Stock Reform Act, Congress authorized the SEC to seek monetary civil penalties. *See* 15 U.S.C. §§ 77h-1(g), 77t(d), 78u(d)(3), 78u-2, 80a-9(d), 80a-41(e), 80b-3(i), and 80b-9(e). That act also specifically authorized the SEC for the first time to seek disgorgement in administrative proceedings. *See* 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e), 80a-9(e) & f(5), and 80b-3(j) & k(5)). Although the wording of the particular statutory provisions varied slightly, all provided that the SEC "may enter an order requiring accounting and disgorgement, including reasonable interest." (For the sake of simplicity, the Court will refer to the various statutory enactments, which are largely identical, in the singular.) Congress did not, however, provide statutory authority to the SEC to obtain disgorgement in civil enforcement proceedings.

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5. Disgorgement has been defined as "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion." Black's Law Dictionary (10th ed. 2014).

In *Kokesh*, the Supreme Court was presented with the following question: whether disgorgement ordered in a civil enforcement proceeding constituted a "penalty" subject to the five-year statute of limitations set forth in 28 U.S.C. § 2462.[6] The Court unanimously held that disgorgement was such a penalty. *Kokesh*, 137 S. Ct. at 1645. It reasoned that disgorged funds rarely go to victims, are designed to deter future violations, and are not limited to the amount of harm caused. *Id.* at 1644-45 ("disgorgement thus bears all the hallmarks of a penalty: It is imposed as a consequence of violating a public law and it is intended to deter, not to compensate.").

The Court observed in a footnote: "Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context." *Id.* at 1642 n.3.

Since *Kokesh*, various parties have attempted to challenge court-ordered disgorgement as exceeding the SEC's statutory authority. Some courts have interpreted *Kokesh* narrowly. *See, e.g., SEC v. Sample*, 2017 U.S. Dist. LEXIS 191025, 2017 WL 5569873, at *2 (N.D. Tex. Nov. 20, 2017) ("*Kokesh* merely held that disgorgement claims are subject to 28 U.S.C. § 2462's five-year statute of limitations. [It] had no effect on how courts apply

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6. That statute provides: "Except as otherwise provided . . . an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture . . . shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ."

disgorgement principles."); *FTC v. J. William Enters., LLC*, 283 F. Supp. 3d 1259, 1262 (M.D. Fla. 2017) ("the Supreme Court's deliberate avoidance of [the question of whether disgorgement is permissible] provides no basis for this Court to disregard decades of precedent"); *SEC v. Jammin Java Corp.*, 2017 U.S. Dist. LEXIS 157730, 2017 WL 4286180, at *3 (C.D. Cal. Sep. 14, 2017) ("As it presently stands, *Kokesh* is best seen as a decision clarifying the statutory scope of § 2462, rather than one redefining the essential attributes of disgorgement."). Other courts have cautioned that *Kokesh* may have abrogated precedents used to justify disgorgement. *See, e.g., United States v. Latorella*, 2017 U.S. Dist. LEXIS 98849, 2017 WL 2785413, at *4 n.4 (D. Mass. June 27, 2017) (Woodlock, J.) ("It bears noting that the Supreme Court [in *Kokesh*] expressly reserved the question whether courts possess authority to order disgorgement in SEC enforcement proceedings."); *SEC v. Amerindo Inv. Advisors, Inc.*, 2017 U.S. Dist. LEXIS 110407, 2017 WL 3017504, at *8 (S.D.N.Y. July 14, 2017); *Saad v. SEC*, 873 F.3d 297, 305 (D.C. Cir. 2017) ("the Supreme Court's decision in *Kokesh* overturned a line of cases from [the D.C. Circuit] that had concluded that disgorgement was remedial and not punitive") (Kavanaugh, J., concurring). None of those cases, however, addressed the issue of disgorgement in an administrative proceeding, which again is specifically authorized by statute.

B. Whether the Statute Permitted the Imposition of Disgorgement

The trustee argues that the SEC's imposition of disgorgement was unlawful because it was a penalty, not

a remedial action intended to benefit investor victims, and because the SEC did not conduct an accounting. (*See* Compl. ¶ 31 (alleging that the agency did not "conduct[] an accounting or return[] funds to investor victims.")). Because Congress has separately provided statutory authority for civil money penalties, the trustee reasons that the SEC is "double-dipping despite statutory limitations" and attempting to rewrite "clear statutory terms." (Mem. in Opp. at 13 (citing *Util. Air Regulatory Group v. EPA*, 573 U.S. 302, 134 S. Ct. 2427, 2446, 189 L. Ed. 2d 372 (2014)). In other words, the trustee contends that as a matter of statutory construction, the term "disgorgement" does not include disgorgement as a form of penalty, and that therefore such disgorgement is not authorized. The trustee also contends that because no accounting occurred, the $30 million disgorgement amount paid in the settlement had no connection either to the net profits obtained by F-Squared from the scheme or the gross proceeds it received from investors.

As noted, Congress in 1990 expressly gave the SEC the authority to obtain disgorgement in administrative proceedings. Whether Congress intended only to provide authority for "disgorgement-as-remedy," but not "disgorgement-as penalty," is not obvious from the statutory language. The statute simply uses the word "disgorgement"; it does not say, for example, "disgorgement of profits" or "disgorgement of proceeds in order to provide restitution to victims."[7]

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7. Disgorgement of profits would eliminate any gain by a violator, but presumably would be insufficient to compensate victims for the loss of their investments; that would normally require disgorgement of some or all of the gross proceeds.

The trustee argues that the term "disgorgement" necessarily excludes punitive disgorgement because the provision permitting civil penalties elsewhere in the statute necessarily precludes other monetary penalties. But many statutory schemes provide for multiple, overlapping forms of penalties (such as imprisonment, fines, and forfeitures in criminal cases). Furthermore, as the trustee himself notes, a broad interpretation of "disgorgement" had been accepted by the courts since the 1970s. It is a basic canon of statutory construction that "Congress is understood to legislate against a background of common-law adjudicatory principles." *Astoria Fed. Sav. and Loan Ass'n v. Solimino*, 501 U.S. 104, 108, 111 S. Ct. 2166, 115 L. Ed. 2d 96 (1991). Twenty years elapsed between the time when the SEC first exercised disgorgement authority in *Texas Gulf Sulphur* and when the Penny Stock Reform Act became law. Arguably, Congress was aware of that long-standing practice and intended to codify it, at least in administrative proceedings.

In any event, this Court need not resolve that issue. Whatever the merits of the trustee's argument as a matter of statutory interpretation, that argument has clearly been waived.

C. <u>Whether the Waiver Is Valid</u>

As noted above, F-Squared, as part of the settlement, clearly and unambiguously waived the right to judicial review by any court. The trustee nonetheless disputes the validity of the waiver on multiple grounds.

First, the trustee contends that the settlement was "narrowly drawn in a manner that does not reach this case." (Mem. in Opp. at 17). In support, the trustee argues that the waiver only applied to "direct reviews of orders and not to collateral claims under the APA." (*Id.*). But the waiver does not say that; instead, by its terms, it applies to "[j[udicial review by any court." A claim under the APA seeks judicial review of an agency action. There is nothing in the settlement to suggest that the waiver of judicial review was limited solely to direct review, as opposed to collateral review under the APA.

Second, the trustee contends that the waiver was "unenforceable because it was based on a mistake of law." (*Id.*). Specifically, he argues that the settlement was the product of a mutual mistake because the parties were proceeding on the incorrect assumption that the SEC had the authority to impose punitive disgorgement, and that no one realized the mistake until the Supreme Court in *Kokesh* ruled to the contrary.

But even if *Kokesh* changed disgorgement law as to civil enforcement proceedings—and the Supreme Court specifically noted it did not—that opinion says nothing about the application of disgorgement in administrative proceedings. Again, there is no question that the statute, then and now, explicitly permits the SEC to require disgorgement in administrative proceedings. The trustee does not contend that the statute is unconstitutional. Rather, and in essence, the trustee is claiming that (1) the SEC misinterpreted the meaning of the term "disgorgement" in the statute; (2) by interpreting the statute too broadly, it was acting outside the

scope of its statutory authority—that is, acting *ultra vires*; and (3) by doing so, the SEC was acting unconstitutionally, in violation of principles of separation of powers. According to the trustee, that is an argument that "may not be waived or bargained away." (*Id.* at 13).

That argument fails, at a minimum, at the last step. Even if the SEC's application of its disgorgement authority was *ultra vires*, any such error by the agency was clearly waivable. In *City of Arlington v. FCC*, 569 U.S. 290, 297-98, 133 S. Ct. 1863, 185 L. Ed. 2d 941 (2013), the Supreme Court rejected a distinction between agency errors that are jurisdictional and those that are non-jurisdictional. Justice Scalia, writing for the Court, observed as follows:

> A court's power to decide a case is independent of whether its decision is correct . . . .
>
> That is not so for agencies charged with administering congressional statutes. Both their power to act and how they are to act is authoritatively prescribed by Congress, so that when they act improperly, no less than when they act beyond their jurisdiction, what they do is ultra vires. Because the question—whether framed as an incorrect application of agency authority or an assertion of authority not conferred—is always whether the agency has gone beyond what Congress has permitted it to do, there is no principled basis for carving out some arbitrary subset of such claims as "jurisdictional."

Id.

Since *City of Arlington*, multiple courts of appeals have held that a party may waive an *ultra vires* challenge to agency action. *See, e.g., PGS Geophysical AS v. Iancu*, 891 F.3d 1354, 1362 (Fed. Cir. 2018) (finding challenge to action of Patent Trial and Appeal Board as *ultra vires* waivable) (citing *CBS Broad., Inc. v. EchoStar Commc'ns Corp.*, 450 F.3d 505, 520 n.27 (11th Cir. 2006)); *Metro-North Commuter R.R. Co. v. Dep't of Labor*, 886 F.3d 97, 108 (2d Cir. 2018) (finding waiver of challenge to agency jurisdiction); *1621 Route 22 W. Operating Co., LLC v. NLRB*, 825 F.3d 128, 140-43 (3d Cir. 2016) (same).

It is thus abundantly clear that any claim that the SEC exceeded its jurisdiction is waivable, and that F-Squared waived its right to assert such a claim. Accordingly, to the extent that the trustee is claiming that the settlement exceeded the jurisdictional authority of the SEC, that claim has been waived.

D. <u>Whether the Challenge Should Have Been Brought in the Court of Appeals</u>

Finally, the trustee contends that his challenge may be brought under the APA, and need not have been brought as a petition for judicial review with the Court of Appeals.

Both the Investment Advisers Act and Investment Company Act provide as follows:

> Any person or party aggrieved by an order issued by the [SEC] may obtain a review of such order in the United States court of

> appeals within any circuit wherein such [party] resides . . . or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the [SEC] be modified or set aside in whole or in part.

15 U.S.C. §§ 80a-42(a) & 80b-13(a). Under those statutes, F-Squared should have filed a petition for review challenging the disgorgement order with either the First Circuit or the D.C. Circuit within sixty days after the order was entered. Because F-Squared entered into the settlement agreement on December 22, 2014, the deadline for filing such a petition expired on February 20, 2015. It is undisputed that no petition for review was ever filed.[8]

When a statute provides for "a particular procedure and time period" for challenging agency actions, the APA does not provide an alternative mechanism for judicial review. *See N.Y. Republican State Comm. v. SEC*, 799 F.3d 1126, 1135-36, 419 U.S. App. D.C. 92 (D.C. Cir. 2015). And as a general matter, "[i]t is well settled that . . . a statute [that] vests jurisdiction in a particular court cuts off original jurisdiction in other courts in all cases covered by that statute." *Telecomm. Research and Action Center*

8. Of course, F-Squared did not file such a petition because the matter had been settled—and it had expressly waived its right to judicial review. But as set forth below, meaningful judicial review was available had F-Squared elected to challenge the disgorgement order. It therefore had a full opportunity, had it chosen not to settle the case, to litigate the claims presented here.

v. FCC, 750 F.2d 70, 77, 242 U.S. App. D.C. 222 (D.C. Cir. 1984).[9] In *Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 114 S. Ct. 771, 127 L. Ed. 2d 29 (1994), the Supreme Court established a framework for determining when a statute forecloses district-court jurisdiction.

The first question is to determine whether such intent is "fairly discernible in the statutory scheme." *Id.* at 207. At least three courts of appeals have already concluded that the exclusive channeling scheme in the federal securities laws clearly reflects such intent. *See Tilton v. SEC*, 824 F.3d 276, 281 (2d Cir. 2016); *Jarkesy v. SEC*, 803 F.3d 9, 15-16, 419 U.S. App. D.C. 394 (D.C. Cir. 2016); *Bebo v. SEC*, 799 F.3d 765, 767 (7th Cir. 2015). The trustee does not appear to challenge that conclusion.

The second question is to determine if the litigant's claims are "of the type Congress intended to be reviewed within [the] statutory structure." *Thunder Basin*, 510 U.S. at 212. In answering that question, district courts are to weigh three factors: (1) the availability of meaningful judicial review, (2) whether the claims are "wholly collateral" to the statutory review provisions, and (3) whether the litigant's claims fall within the agency's expertise. *See Tilton*, 824 F.3d at 282-91. Those three factors are "general guideposts" rather than "distinct

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9. The trustee bears the burden of establishing that the court has subject-matter jurisdiction. *See Amoche v. Guar. Trust Life Ins. Co.*, 556 F.3d 41, 48 (1st Cir. 2009). "The usual rule in class actions is that that to establish subject[-]matter jurisdiction one looks only to the named plaintiffs and their claims." *Pruell v. Caritas Christi*, 645 F.3d 81, 83 (1st Cir. 2011). Accordingly, the Court will consider only the trustee's claims.

inputs" in "a strict mathematical formula." *Jarkesy*, 803 F.3d at 17.

1. **Meaningful Judicial Review**

The availability of meaningful review has been characterized as the "most important" *Thunder Basin* factor. *See Bebo*, 799 F.3d at 774-75. The trustee here relies heavily on *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 130 S. Ct. 3138, 177 L. Ed. 2d 706 (2010), in which the Supreme Court held that a provision of the Exchange Act governing challenges to final SEC orders did not strip district courts of jurisdiction to hear a constitutional challenge to the Public Company Accounting Oversight Board ("PCAOB"). *Id.* at 489. Writing for the Court, Chief Justice Roberts wrote that "[p]rovisions for agency review do not restrict judicial review unless the statutory scheme displays a fairly discernible intent to limit jurisdiction, and the claims at issue are of the type Congress intended to be reviewed within the statutory structure." (citation and internal quotation marks omitted). *Id.* However, in *Free Enterprise Fund*, the plaintiffs were challenging the constitutionality of PCAOB itself. The Court reasoned that meaningful judicial review would not be provided if plaintiffs were first required to "bet the farm" by violating a PCAOB rule to test the board's legitimacy. *Id.* at 490-91. By contrast, there was undoubtedly an avenue for meaningful judicial review here—unlike in *Free Enterprise Fund*, F-Squared was already subject to a final SEC action (the order requiring disgorgement), which could have been appealed to the Court of Appeals.[10]

10. The trustee also relies on *McNary v. Haitian Refugee Center, Inc.*, 498 U.S. 479, 111 S. Ct. 888, 112 L. Ed. 2d 1005 (1991).

The trustee similarly relies on *Freytag v. Commissioner*, 501 U.S. 868, 111 S. Ct. 2631, 115 L. Ed. 2d 764 (1991), in which the Supreme Court rejected the government's arguments that petitioners had waived their right to challenge the constitutionality of a statute by failing to make a timely objection before a Special Trial Judge. The trustee here argues that structural constitutional challenges to agency actions are exempt from statutes restricting judicial review. However, he ignores a long line of judicial precedent upholding statutes that provide for exclusive channeling schemes. The Supreme Court recently addressed this issue in *Elgin v. Dep't of Treasury*, 567 U.S. 1, 11-12, 132 S. Ct. 2126, 183 L. Ed. 2d 1 (2012), when it upheld a provision in the Civil Service Reform Act limiting judicial review of decisions from the Merit Systems Protection Board to the Federal Circuit. Accordingly, meaningful judicial review was available to F-Squared under the circumstances presented here.

2. "Wholly Collateral"

Next, the court must consider whether the trustee's claims are "wholly collateral" to the statutory scheme of the securities laws. That question is interrelated with the question of meaningful judicial review. *See Free Enterprise Fund*, 561 U.S. at 489-90 (analyzing both factors simultaneously).

In *McNary*, the Court held that requiring aliens to "voluntarily surrender themselves for deportation" to challenge their denial of Special Agricultural Worker status under the Immigration Reform Control Act was "tantamount to a complete denial of judicial review." *Id.* at 496-97. Again, no such concern was present here.

The Supreme Court did not explain in *Thunder Basin* or its progeny how to determine whether a claim is "wholly collateral." However, the *Elgin* court suggested that a claim is not "wholly collateral if it serves as the 'vehicle by which' a party seeks to prevail in an administrative proceeding." *Tilton*, 824 F.3d at 287 (quoting *Elgin*, 567 U.S. at 22). Lower courts have largely concluded that a claim is "not wholly collateral if it has been raised in response to, and so is procedurally intertwined with, an administrative proceeding—regardless of the claim's substantive connection to the initial merits dispute in the proceeding." *Id.* (citing *Jarkesy*, 803 F.3d at 23; *Bebo v. SEC*, 2015 U.S. Dist. LEXIS 25660, 2015 WL 905349, at *2-4 (E.D. Wis. Mar, 3, 2015).[11]

Here, the trustee's argument, at least arguably, is substantively "unrelated to the securities violations underlying the administrative proceeding." *Tilton v. SEC*, 2015 U.S. Dist. LEXIS 85015, 2015 WL 4006165, at *11 (S.D.N.Y. June 30, 2015). Nevertheless, the claims raised in the complaint were indisputably raised in response to the SEC administrative proceeding. And had F-Squared timely filed a petition for review with the Court of Appeals, those claims would have been the "vehicle by which" it sought to prevail. Nothing barred F-Squared from raising

11. Earlier, two other lower courts found that a claim was not wholly collateral to an administrative proceeding only if was substantively intertwined with the merits dispute that the proceeding was commenced to resolve. *See Hill v. SEC*, 114 F. Supp. 3d 1297, 1309 (N.D. Ga. 2015) (vacated by *Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016)); *Duka v. SEC*, 103 F. Supp. 3d 382, 391 (S.D.N.Y. 2015) (abrogated by *Tilton*, 824 F.3d 276).

those claims within the exclusive channeling scheme. Accordingly, the trustee's claims are not wholly collateral to that scheme.

3. Agency Expertise

Finally, the court must determine whether the particular claims here fall within the SEC's expertise. That is a closer question—in *Free Enterprise Fund*, the Supreme Court held that petitioners' constitutional claims were "outside the [SEC's] competence and expertise." 561 U.S. at 491. However, in *Elgin*, the Supreme Court provided guiding language stating that agencies could use their expertise to resolve "the many threshold questions that may accompany a constitutional claim." 567 U.S. at 22.

Here, the trustee is substantively challenging the SEC's interpretation of "disgorgement" in the securities laws. Agencies routinely address such statutory claims. *See Tilton*, 824 F.3d at 290 ("[W]e think that the SEC might bring its expertise to bear on the appellants' proceeding by resolving accompanying statutory claims that it routinely considers, and which might fully dispose of the case.") (citation and quotation marks omitted); *Jarkesy*, 803 F.3d at 29 ("[T]he [SEC] could offer an interpretation of the securities laws in the course of the proceeding that might answer or shed light on [appellant's constitutional] challenge."). Therefore, the agency had sufficient expertise to consider the trustee's claims during the proceedings against F-Squared. In any event, even assuming that the SEC was "powerless" to consider the trustee's claims, that alone is insufficient to "bypass the

statutory remedial scheme" "because meaningful review of those claims in an Article III Court of Appeals [was] available." *Tilton*, 2015 U.S. Dist. LEXIS 85015, 2015 WL 4006165, at *13.

Again, F-Squared never presented the trustee's arguments to the SEC—instead, it voluntarily entered into a settlement agreement. Those arguments could then have been presented to the Court of Appeals in a petition for review more than three years ago. Allowing the trustee to circumvent the procedure explicitly set forth by Congress to challenge that settlement would undermine the finality and certainty of SEC orders. *See N.Y. Republican State Comm.*, 799 F.3d at 1136.

In short, the trustee's claims were subject to review within the SEC's exclusive statutory structure, and should have been raised with the Court of Appeals. The fact that this claim has been repackaged under the heading of an APA claim does not exempt it from the exclusive channeling regime Congress prescribed. *See e.g., Jarkesy*, 803 F.3d at 29-30 (holding that the exclusive channeling scheme in the Securities Act and Exchange Act provided the sole means for judicial review despite claims of constitutional violations). This Court accordingly does not have subject-matter jurisdiction over the claims raised.

4. <u>The Applicability of 15 U.S.C. § 80b-13</u>

Finally, during the motion hearing, counsel for the trustee cited excerpts from 15 U.S.C. § 80b-13 for the proposition that the Court of Appeals does not have

exclusive jurisdiction of final SEC orders until a petition for review has been filed with that court.[12] However, counsel is cherry-picking statutory terms in order to create an incorrect interpretation of the statute. It is black-letter law that filing a notice of appeal in a civil proceeding confers sole jurisdiction on the courts of appeals, divesting district courts of jurisdiction. *See Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56, 58-59, 103 S. Ct. 400, 74 L. Ed. 2d 225 (1982). Section 80b-13 is the parallel provision in the Investment Advisers Act that divests the SEC of jurisdiction after a petition for review is filed with the Court of Appeals. The federal securities laws clearly do not grant district courts jurisdiction to review SEC orders in administrative proceedings except in one

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12. 15 U.S.C. § 80b-13(a) provides as follows:

> Any person or party aggrieved by an order issued by the [SEC] may obtain a review of such order in the United States court of appeals . . . by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the [SEC] be modified or set aside in whole or in part.
>
> A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the [SEC], or any officer thereof designated by the [SEC] for that purpose, and thereupon the [SEC] shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. *Upon the filing of such petition* such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, or set aside such order, in whole or in part.

(emphasis added).

narrow circumstance—to review temporary cease and desist orders—which is not present here. *See e.g.*, 15 U.S.C. § 80b-3(k)(3)(A), (4)(B) (Investment Advisers Act).

IV. Conclusion

For the foregoing reasons, defendant's motion to dismiss for failure to state a claim and lack of subject-matter jurisdiction is GRANTED.

So Ordered.

/s/ F. Dennis Saylor
F. Dennis Saylor IV
United States District Judge

Dated: August 22, 2018

APPENDIX C — RELEVANT STATUTORY PROVISIONS

15 U.S.C. § 80a-9

§ 80a-9. Ineligibility of certain affiliated persons and underwriters

Effective: July 22, 2010

(a) Persons deemed ineligible for service with investment companies, etc.; investment adviser

It shall be unlawful for any of the following persons to serve or act in the capacity of employee, officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:

(1) any person who within 10 years has been convicted of any felony or misdemeanor involving the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer, investment adviser, municipal securities dealer, government securities broker, government securities dealer, bank, transfer agent, credit rating agency, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated person, salesman, or employee of any investment company, bank, insurance company, or entity or person required to be registered under the Commodity Exchange Act;

(2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, investment adviser, municipal securities dealer, government securities broker, government securities dealer, bank, transfer agent, credit rating agency, or entity or person required to be registered under the Commodity Exchange Act, or as an affiliated person, salesman, or employee of any investment company, bank, insurance company, or entity or person required to be registered under the Commodity Exchange Act, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; or

(3) a company any affiliated person of which is ineligible, by reason of paragraph (1) or (2) of this subsection, to serve or act in the foregoing capacities.

For the purposes of paragraphs (1) to (3) of this subsection, the term "investment adviser" shall include an investment adviser as defined in subchapter II of this chapter.

(b) Certain persons serving investment companies; administrative action of Commission

The Commission may, after notice and opportunity for hearing, by order prohibit, conditionally or unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer,

director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, if such person--

(1) has willfully made or caused to be made in any registration statement, application or report filed with the Commission under this subchapter any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such registration statement, application, or report any material fact which was required to be stated therein;

(2) has willfully violated any provision of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of subchapter II of this chapter, or of this subchapter, or of the Commodity Exchange Act, or of any rule or regulation under any of such statutes;

(3) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of subchapter II of this chapter, or of this subchapter, or of the Commodity Exchange Act, or of any rule or regulation under any of such statutes;

(4) has been found by a foreign financial regulatory authority to have--

(A) made or caused to be made in any application for registration or report required to be filed with a foreign securities authority, or in any proceeding before a foreign securities authority with respect to registration, any statement that was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any application or report to a foreign securities authority any material fact that is required to be stated therein;

(B) violated any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade; or

(C) aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade;

(5) within 10 years has been convicted by a foreign court of competent jurisdiction of a crime, however denominated by the laws of the relevant foreign government, that is substantially equivalent to an offense set forth in paragraph (1) of subsection (a); or

(6) by reason of any misconduct, is temporarily or permanently enjoined by any foreign court of competent jurisdiction from acting in any of the capacities, set forth in paragraph (2) of subsection (a), or a substantially equivalent foreign capacity, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security.

(c) Application of ineligible person for exemption

Any person who is ineligible, by reason of subsection (a), to serve or act in the capacities enumerated in such subsection, may file with the Commission an application for an exemption from the provisions of such subsection. The Commission shall by order grant such application, either unconditionally or on an appropriate temporary or other conditional basis, if it is established that the prohibitions of such subsection (a) as applied to such person, are unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such application.

(d) Money penalties in administrative proceedings

(1) Authority of Commission

(A) In general

In any proceeding instituted pursuant to subsection (b) against any person, the Commission may impose

a civil penalty if it finds, on the record after notice and opportunity for hearing, that such penalty is in the public interest, and that such person--

(i) has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, subchapter II of this chapter, or this subchapter, or the rules or regulations thereunder;

(ii) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person; or

(iii) has willfully made or caused to be made in any registration statement, application, or report required to be filed with the Commission under this subchapter, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such registration statement, application, or report any material fact which was required to be stated therein;[1]

(B) Cease-and-desist proceedings

In any proceeding instituted pursuant to subsection (f) against any person, the Commission may impose a civil penalty if the Commission finds, on the

1. So in original. The semicolon probably should be a period.

record, after notice and opportunity for hearing, that such person--

(i) is violating or has violated any provision of this subchapter, or any rule or regulation issued under this subchapter; or

(ii) is or was a cause of the violation of any provision of this subchapter, or any rule or regulation issued under this subchapter.

(2) Maximum amount of penalty

(A) First tier

The maximum amount of penalty for each act or omission described in paragraph (1) shall be $5,000 for a natural person or $50,000 for any other person.

(B) Second tier

Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be $50,000 for a natural person or $250,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) Third tier

Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be $100,000 for a natural person or $500,000 for any other person if--

(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(ii) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

(3) Determination of public interest

In considering under this section whether a penalty is in the public interest, the Commission may consider--

(A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

(B) the harm to other persons resulting either directly or indirectly from such act or omission;

(C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;

(D) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 80b-3(e)(2) of this title;

(E) the need to deter such person and other persons from committing such acts or omissions; and

(F) such other matters as justice may require.

(4) Evidence concerning ability to pay

In any proceeding in which the Commission may impose a penalty under this section, a respondent may present evidence of the respondent's ability to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of such person's ability to continue in business and the collectability of a penalty, taking into account any other claims of the United States or

third parties upon such person's assets and the amount of such person's assets.

(e) Authority to enter order requiring accounting and disgorgement

In any proceeding in which the Commission may impose a penalty under this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

(f) Cease-and-desist proceedings

(1) Authority of Commission

If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this subchapter, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such

person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, any issuer, or any other person.

(2) Hearing

The notice instituting proceedings pursuant to paragraph (1) shall fix a hearing date not earlier than 30 days nor later than 60 days after service of the notice unless an earlier or a later date is set by the Commission with the consent of any respondent so served.

(3) Temporary order

(A) In general

Whenever the Commission determines that the alleged violation or threatened violation specified in the notice instituting proceedings pursuant to paragraph (1), or the continuation thereof, is likely to result in significant dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest, including, but not limited to, losses to the Securities Investor

Protection Corporation, prior to the completion of the proceeding, the Commission may enter a temporary order requiring the respondent to cease and desist from the violation or threatened violation and to take such action to prevent the violation or threatened violation and to prevent dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest as the Commission deems appropriate pending completion of such proceedings. Such an order shall be entered only after notice and opportunity for a hearing, unless the Commission, notwithstanding section 80a-39(a) of this title, determines that notice and hearing prior to entry would be impracticable or contrary to the public interest. A temporary order shall become effective upon service upon the respondent and, unless set aside, limited, or suspended by the Commission or a court of competent jurisdiction, shall remain effective and enforceable pending the completion of the proceedings.

(B) Applicability

This paragraph shall apply only to a respondent that acts, or, at the time of the alleged misconduct acted, as a broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, government securities dealer, or transfer agent, or is, or was at the time of the alleged misconduct, an associated person of, or a person seeking to become associated

with, any of the foregoing.

(4) Review of temporary orders

(A) Commission review

At any time after the respondent has been served with a temporary cease-and-desist order pursuant to paragraph (3), the respondent may apply to the Commission to have the order set aside, limited, or suspended. If the respondent has been served with a temporary cease-and-desist order entered without a prior Commission hearing, the respondent may, within 10 days after the date on which the order was served, request a hearing on such application and the Commission shall hold a hearing and render a decision on such application at the earliest possible time.

(B) Judicial review

Within--

(i) 10 days after the date the respondent was served with a temporary cease-and-desist order entered with a prior Commission hearing, or

(ii) 10 days after the Commission renders a decision on an application and hearing under subparagraph (A), with respect to any temporary cease-and-desist order entered without a prior Commission hearing,

the respondent may apply to the United States district court for the district in which the respondent resides or has its principal place of business, or for the District of Columbia, for an order setting aside, limiting, or suspending the effectiveness or enforcement of the order, and the court shall have jurisdiction to enter such an order. A respondent served with a temporary cease-and-desist order entered without a prior Commission hearing may not apply to the court except after hearing and decision by the Commission on the respondent's application under subparagraph (A) of this paragraph.

(C) No automatic stay of temporary order

The commencement of proceedings under subparagraph (B) of this paragraph shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(D) Exclusive review

Section 80a-42 of this title shall not apply to a temporary order entered pursuant to this section.

(5) Authority to enter order requiring accounting and disgorgement

In any cease-and-desist proceeding under subsection (f)(1), the Commission may enter an order requiring

accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

(g) Corporate or other trustees performing functions of investment advisers

For the purposes of this section, the term "investment adviser" includes a corporate or other trustee performing the functions of an investment adviser.

Appendix C

15 U.S.C. § 80b-3

§ 80b-3. Registration of investment advisers

Effective: January 3, 2019

(a) Necessity of registration

Except as provided in subsection (b) and section 80b-3a of this title, it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser.

(b) Investment advisers who need not be registered

The provisions of subsection (a) shall not apply to--

(1) any investment adviser, other than an investment adviser who acts as an investment adviser to any private fund, all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

(2) any investment adviser whose only clients are insurance companies;

(3) any investment adviser that is a foreign private adviser;

(4) any investment adviser that is a charitable organization, as defined in section 80a-3(c)(10)(D) of this title, or is a trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, whose advice, analyses, or reports are provided only to one or more of the following:

(A) any such charitable organization;

(B) a fund that is excluded from the definition of an investment company under section 80a-3(c)(10)(B) of this title; or

(C) a trust or other donative instrument described in section 80a-3(c)(10)(B) of this title, or the trustees, administrators, settlors (or potential settlors), or beneficiaries of any such trust or other instrument;

(5) any plan described in section 414(e) of Title 26, any person or entity eligible to establish and maintain such a plan under Title 26, or any trustee, director, officer, or employee of or volunteer for any such plan or person, if such person or entity, acting in such capacity, provides investment advice exclusively to, or with respect to, any plan, person, or entity or any company, account, or fund that is excluded from the definition of an investment company under section 80a-3(c)(14) of this title;

(6)(A) any investment adviser that is registered with the Commodity Futures Trading Commission as a

commodity trading advisor whose business does not consist primarily of acting as an investment adviser, as defined in section 80b-2(a)(11) of this title, and that does not act as an investment adviser to--

(i) an investment company registered under subchapter I of this chapter; or

(ii) a company which has elected to be a business development company pursuant to section 80a-53 of this title and has not withdrawn its election; or

(B) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor and advises a private fund, provided that, if after July 21, 2010, the business of the advisor should become predominately the provision of securities-related advice, then such adviser shall register with the Commission;

(7) any investment adviser, other than any entity that has elected to be regulated or is regulated as a business development company pursuant to section 80a-53 of this title, who solely advises--

(A) small business investment companies that are licensees under the Small Business Investment Act of 1958;

(B) entities that have received from the Small Business Administration notice to proceed to

qualify for a license as a small business investment company under the Small Business Investment Act of 1958, which notice or license has not been revoked; or

(C) applicants that are affiliated with 1 or more licensed small business investment companies described in subparagraph (A) and that have applied for another license under the Small Business Investment Act of 1958, which application remains pending; or

(8) any investment adviser, other than an entity that has elected to be regulated or is regulated as a business development company pursuant to section 80a-53 of this title, who solely advises--

(A) rural business investment companies (as defined in section 2009cc of Title 7); or

(B) companies that have submitted to the Secretary of Agriculture an application in accordance with section 2009cc-3(b) of Title 7 that--

(i) have received from the Secretary of Agriculture a letter of conditions, which has not been revoked; or

(ii) are affiliated with 1 or more rural business investment companies described in subparagraph (A).

(c) Procedure for registration; filing of application; effective date of registration; amendment of registration

(1) An investment adviser, or any person who presently contemplates becoming an investment adviser, may be registered by filing with the Commission an application for registration in such form and containing such of the following information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors:

(A) the name and form of organization under which the investment adviser engages or intends to engage in business; the name of the State or other sovereign power under which such investment adviser is organized; the location of his or its principal office, principal place of business, and branch offices, if any; the names and addresses of his or its partners, officers, directors, and persons performing similar functions or, if such an investment adviser be an individual, of such individual; and the number of his or its employees;

(B) the education, the business affiliations for the past ten years, and the present business affiliations of such investment adviser and of his or its partners, officers, directors, and persons performing similar functions and of any controlling person thereof;

(C) the nature of the business of such investment adviser, including the manner of giving advice and rendering analyses or reports;

(D) a balance sheet certified by an independent public accountant and other financial statements (which shall, as the Commission specifies, be certified);

(E) the nature and scope of the authority of such investment adviser with respect to clients' funds and accounts;

(F) the basis or bases upon which such investment adviser is compensated;

(G) whether such investment adviser, or any person associated with such investment adviser, is subject to any disqualification which would be a basis for denial, suspension, or revocation of registration of such investment adviser under the provisions of subsection (e) of this section; and

(H) a statement as to whether the principal business of such investment adviser consists or is to consist of acting as investment adviser and a statement as to whether a substantial part of the business of such investment adviser, consists or is to consist of rendering investment supervisory services.

(2) Within forty-five days of the date of the filing of such application (or within such longer period as to which the applicant consents) the Commission shall--

(A) by order grant such registration; or

(B) institute proceedings to determine whether registration should be denied. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing and shall be concluded within one hundred twenty days of the date of the filing of the application for registration. At the conclusion of such proceedings the Commission, by order, shall grant or deny such registration. The Commission may extend the time for conclusion of such proceedings for up to ninety days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the applicant consents.

The Commission shall grant such registration if the Commission finds that the requirements of this section are satisfied and that the applicant is not prohibited from registering as an investment adviser under section 80b-3a of this title. The Commission shall deny such registration if it does not make such a finding or if it finds that if the applicant were so registered, its registration would be subject to suspension or revocation under subsection (e) of this section.

(d) Other acts prohibited by subchapter

Any provision of this subchapter (other than subsection (a) of this section) which prohibits any act, practice, or course of business if the mails or any means or instrumentality of interstate commerce are used in connection therewith shall also prohibit any such act, practice, or course of business by any investment adviser registered pursuant

to this section or any person acting on behalf of such an investment adviser, irrespective of any use of the mails or any means or instrumentality of interstate commerce in connection therewith.

(e) Censure, denial, or suspension of registration; notice and hearing

The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any investment adviser if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such investment adviser, or any person associated with such investment adviser, whether prior to or subsequent to becoming so associated--

(1) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this subchapter, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein.

(2) has been convicted within ten years preceding the filing of any application for registration or at any time thereafter of any felony or misdemeanor or of a substantially equivalent crime by a foreign court of

competent jurisdiction which the Commission finds--

(A) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, any substantially equivalent activity however denominated by the laws of the relevant foreign government, or conspiracy to commit any such offense;

(B) arises out of the conduct of the business of a broker, dealer, municipal securities dealer, investment adviser, bank, insurance company, government securities broker, government securities dealer, fiduciary, transfer agent, credit rating agency, foreign person performing a function substantially equivalent to any of the above, or entity or person required to be registered under the Commodity Exchange Act or any substantially equivalent statute or regulation;

(C) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities or substantially equivalent activity however denominated by the laws of the relevant foreign government; or

(D) involves the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of Title 18, or a violation of[2] substantially equivalent foreign statute.

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2. So in original. Probably should be "of a".

(3) has been convicted during the 10-year period preceding the date of filing of any application for registration, or at any time thereafter, of--

(A) any crime that is punishable by imprisonment for 1 or more years, and that is not described in paragraph (2); or

(B) a substantially equivalent crime by a foreign court of competent jurisdiction.

(4) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction, including any foreign court of competent jurisdiction, from acting as an investment adviser, underwriter, broker, dealer, municipal securities dealer, government securities broker, government securities dealer, transfer agent, credit rating agency, foreign person performing a function substantially equivalent to any of the above, or entity or person required to be registered under the Commodity Exchange Act or any substantially equivalent statute or regulation, or as an affiliated person or employee of any investment company, bank, insurance company, foreign entity substantially equivalent to any of the above, or entity or person required to be registered under the Commodity Exchange Act or any substantially equivalent statute or regulation, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

(5) has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, subchapter I of this chapter, this subchapter, the Commodity Exchange Act, or the rules or regulations under any such statutes or any rule of the Municipal Securities Rulemaking Board, or is unable to comply with any such provision.

(6) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, subchapter I of this chapter, this subchapter, the Commodity Exchange Act, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this paragraph no person shall be deemed to have failed reasonably to supervise any person, if--

> **(A)** there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and
>
> **(B)** such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without

reasonable cause to believe that such procedures and system were not being complied with.

(7) is subject to any order of the Commission barring or suspending the right of the person to be associated with an investment adviser;

(8) has been found by a foreign financial regulatory authority to have--

(A) made or caused to be made in any application for registration or report required to be filed with a foreign securities authority, or in any proceeding before a foreign securities authority with respect to registration, any statement that was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any application or report to a foreign securities authority any material fact that is required to be stated therein;

(B) violated any foreign statute or regulation regarding transactions in securities or contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market or any board of trade; or

(C) aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any foreign statute or regulation regarding transactions in securities or contracts of sale of a

commodity for future delivery traded on or subject to the rules of a contract market or any board of trade, or has been found, by the foreign financial[3] regulatory authority, to have failed reasonably to supervise, with a view to preventing violations of statutory provisions, and rules and regulations promulgated thereunder, another person who commits such a violation, if such other person is subject to his supervision; or

(9) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 1813(q) of Title 12), or the National Credit Union Administration, that--

(A) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

(B) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.

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3. So in original. Probably should be "financial".

(f) Bar or suspension from association with investment adviser; notice and hearing

The Commission, by order, shall censure or place limitations on the activities of any person associated, seeking to become associated, or, at the time of the alleged misconduct, associated or seeking to become associated with an investment adviser, or suspend for a period not exceeding 12 months or bar any such person from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in paragraph (1), (5), (6), (8), or (9) of subsection (e) or has been convicted of any offense specified in paragraph (2) or (3) of subsection (e) within ten years of the commencement of the proceedings under this subsection, or is enjoined from any action, conduct, or practice specified in paragraph (4) of subsection (e). It shall be unlawful for any person as to whom such an order suspending or barring him from being associated with an investment adviser is in effect willfully to become, or to be, associated with an investment adviser without the consent of the Commission, and it shall be unlawful for any investment adviser to permit such a person to become, or remain, a person associated with him without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order.

(g) Registration of successor to business of investment adviser

Any successor to the business of an investment adviser registered under this section shall be deemed likewise registered hereunder, if within thirty days from its succession to such business it shall file an application for registration under this section, unless and until the Commission, pursuant to subsection (c) or subsection (e) of this section, shall deny registration to or revoke or suspend the registration of such successor.

(h) Withdrawal of registration

Any person registered under this section may, upon such terms and conditions as the Commission finds necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any person registered under this section, or who has pending an application for registration filed under this section, is no longer in existence, is not engaged in business as an investment adviser, or is prohibited from registering as an investment adviser under section 80b-3a of this title, the Commission shall by order cancel the registration of such person.

(i) Money penalties in administrative proceedings

(1) Authority of Commission

(A) In general

In any proceeding instituted pursuant to subsection (e) or (f) against any person, the Commission may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such penalty is in the public interest and that such person--

(i) has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, subchapter I of this chapter, or this subchapter, or the rules or regulations thereunder;

(ii) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;

(iii) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this subchapter, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which was required to be stated therein; or

(iv) has failed reasonably to supervise, within the meaning of subsection (e)(6), with a view to preventing violations of the provisions of

this subchapter and the rules and regulations thereunder, another person who commits such a violation, if such other person is subject to his supervision;[4]

(B) Cease-and-desist proceedings

In any proceeding instituted pursuant to subsection (k) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person--

(i) is violating or has violated any provision of this subchapter, or any rule or regulation issued under this subchapter; or

(ii) is or was a cause of the violation of any provision of this subchapter, or any rule or regulation issued under this subchapter.

(2) Maximum amount of penalty

(A) First tier

The maximum amount of penalty for each act or omission described in paragraph (1) shall be $5,000 for a natural person or $50,000 for any other person.

4. So in original. The semicolon probably should be a period.

(B) Second tier

Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be $50,000 for a natural person or $250,000 for any other person if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) Third tier

Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be $100,000 for a natural person or $500,000 for any other person if--

(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(ii) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

(3) Determination of public interest

In considering under this section whether a penalty is in the public interest, the Commission may consider--

(A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

(B) the harm to other persons resulting either directly or indirectly from such act or omission;

(C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;

(D) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in subsection (e)(2);

(E) the need to deter such person and other persons from committing such acts or omissions; and

(F) such other matters as justice may require.

(4) Evidence concerning ability to pay

In any proceeding in which the Commission may impose a penalty under this section, a respondent may

present evidence of the respondent's ability to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of such person's ability to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon such person's assets and the amount of such person's assets.

(j) Authority to enter order requiring accounting and disgorgement

In any proceeding in which the Commission may impose a penalty under this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

(k) Cease-and-desist proceedings

(1) Authority of Commission

If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this subchapter, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or

omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, any issuer, or any other person.

(2) Hearing

The notice instituting proceedings pursuant to paragraph (1) shall fix a hearing date not earlier than 30 days nor later than 60 days after service of the notice unless an earlier or a later date is set by the Commission with the consent of any respondent so served.

(3) Temporary order

(A) In general

Whenever the Commission determines that the alleged violation or threatened violation specified

in the notice instituting proceedings pursuant to paragraph (1), or the continuation thereof, is likely to result in significant dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest, including, but not limited to, losses to the Securities Investor Protection Corporation, prior to the completion of the proceedings, the Commission may enter a temporary order requiring the respondent to cease and desist from the violation or threatened violation and to take such action to prevent the violation or threatened violation and to prevent dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest as the Commission deems appropriate pending completion of such proceedings. Such an order shall be entered only after notice and opportunity for a hearing, unless the Commission, notwithstanding section 80b-11(c) of this title, determines that notice and hearing prior to entry would be impracticable or contrary to the public interest. A temporary order shall become effective upon service upon the respondent and, unless set aside, limited, or suspended by the Commission or a court of competent jurisdiction, shall remain effective and enforceable pending the completion of the proceedings.

(B) Applicability

This paragraph shall apply only to a respondent that acts, or, at the time of the alleged misconduct

acted, as a broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, government securities dealer, or transfer agent, or is, or was at the time of the alleged misconduct, an associated person of, or a person seeking to become associated with, any of the foregoing.

(4) Review of temporary orders

(A) Commission review

At any time after the respondent has been served with a temporary cease-and-desist order pursuant to paragraph (3), the respondent may apply to the Commission to have the order set aside, limited, or suspended. If the respondent has been served with a temporary cease-and-desist order entered without a prior Commission hearing, the respondent may, within 10 days after the date on which the order was served, request a hearing on such application and the Commission shall hold a hearing and render a decision on such application at the earliest possible time.

(B) Judicial review

Within--

(i) 10 days after the date the respondent was served with a temporary cease-and-desist order entered with a prior Commission hearing, or

(ii) 10 days after the Commission renders a decision on an application and hearing under subparagraph (A), with respect to any temporary cease-and-desist order entered without a prior Commission hearing,

the respondent may apply to the United States district court for the district in which the respondent resides or has its principal office or place of business, or for the District of Columbia, for an order setting aside, limiting, or suspending the effectiveness or enforcement of the order, and the court shall have jurisdiction to enter such an order. A respondent served with a temporary cease-and-desist order entered without a prior Commission hearing may not apply to the court except after hearing and decision by the Commission on the respondent's application under subparagraph (A) of this paragraph.

(C) No automatic stay of temporary order

The commencement of proceedings under subparagraph (B) of this paragraph shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(D) Exclusive review

Section 80b-13 of this title shall not apply to a temporary order entered pursuant to this section.

(5) Authority to enter order requiring accounting and disgorgement

In any cease-and-desist proceeding under paragraph (1), the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

(l) Exemption of venture capital fund advisers

(1) In general

No investment adviser that acts as an investment adviser solely to 1 or more venture capital funds shall be subject to the registration requirements of this subchapter with respect to the provision of investment advice relating to a venture capital fund. Not later than 1 year after July 21, 2010, the Commission shall issue final rules to define the term "venture capital fund" for purposes of this subsection. The Commission shall require such advisers to maintain such records and provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.

(2) Advisers of SBICS

For purposes of this subsection, a venture capital fund includes an entity described in subparagraph (A), (B),

or (C) of subsection (b)(7) (other than an entity that has elected to be regulated or is regulated as a business development company pursuant to section 80a-53 of this title).

(3) Advisers of RBICS

For purposes of this subsection, a venture capital fund includes an entity described in subparagraph (A) or (B) of subsection (b)(8) (other than an entity that has elected to be regulated as a business development company pursuant to section 80a-53 of this title).

(m) Exemption of and reporting by certain private fund advisers

(1) In general

The Commission shall provide an exemption from the registration requirements under this section to any investment adviser of private funds, if each of[5] such investment adviser acts solely as an adviser to private funds and has assets under management in the United States of less than $150,000,000.

(2) Reporting

The Commission shall require investment advisers exempted by reason of this subsection to maintain such records and provide to the Commission such

5. So in original. The word "of" probably should not appear.

annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.

(3) Advisers of SBICS

For purposes of this subsection, the assets under management of a private fund that is an entity described in subparagraph (A), (B), or (C) of subsection (b)(7) (other than an entity that has elected to be regulated or is regulated as a business development company pursuant to section 80a-53 of this title) shall be excluded from the limit set forth in paragraph (1).

(4) Advisers of RBICS

For purposes of this subsection, the assets under management of a private fund that is an entity described in subparagraph (A) or (B) of subsection (b)(8) (other than an entity that has elected to be regulated or is regulated as a business development company pursuant to section 80a-53 of this title) shall be excluded from the limit set forth in paragraph (1).

(n) Registration and examination of mid-sized private fund advisers

In prescribing regulations to carry out the requirements of this section with respect to investment advisers acting as investment advisers to mid-sized private funds, the Commission shall take into account the size, governance, and investment strategy of such funds to determine

whether they pose systemic risk, and shall provide for registration and examination procedures with respect to the investment advisers of such funds which reflect the level of systemic risk posed by such funds.

Appendix C

17 C.F.R. § 201.240

§ 201.240 Settlement.

(a) Availability. Any person who is notified that a proceeding may or will be instituted against him or her, or any party to a proceeding already instituted, may, at any time, propose in writing an offer of settlement.

(b) Procedure. An offer of settlement shall state that it is made pursuant to this section; shall recite or incorporate as a part of the offer the provisions of paragraphs (c)(4) and (5) of this section; shall be signed by the person making the offer, not by counsel; and shall be submitted to the interested division.

(c) Consideration of offers of settlement.

(1) Offers of settlement shall be considered by the interested division when time, the nature of the proceedings, and the public interest permit.

(2) Where a hearing officer is assigned to a proceeding, the interested division and the party submitting the offer may request that the hearing officer express his or her views regarding the appropriateness of the offer of settlement. A request for the hearing officer to express his or her views on an offer of settlement or otherwise to participate in a settlement conference constitutes a waiver by the persons making the request of any right to claim bias or prejudgment by the hearing officer based on the views expressed.

(3) The interested division shall present the offer of settlement to the Commission with its recommendation, except that, if the division's recommendation is unfavorable, the offer shall not be presented to the Commission unless the person making the offer so requests.

(4) By submitting an offer of settlement, the person making the offer waives, subject to acceptance of the offer:

(i) All hearings pursuant to the statutory provisions under which the proceeding is to be or has been instituted;

(ii) The filing of proposed findings of fact and conclusions of law;

(iii) Proceedings before, and an initial decision by, a hearing officer;

(iv) All post-hearing procedures; and

(v) Judicial review by any court.

(5) By submitting an offer of settlement the person further waives:

(i) Such provisions of the Rules of Practice or other requirements of law as may be construed to prevent any member of the Commission's staff from participating in the preparation of, or advising

the Commission as to, any order, opinion, finding of fact, or conclusion of law to be entered pursuant to the offer; and

(ii) Any right to claim bias or prejudgment by the Commission based on the consideration of or discussions concerning settlement of all or any part of the proceeding.

(6) If the Commission rejects the offer of settlement, the person making the offer shall be notified of the Commission's action and the offer of settlement shall be deemed withdrawn. The rejected offer shall not constitute a part of the record in any proceeding against the person making the offer, provided, however, that rejection of an offer of settlement does not affect the continued validity of waivers pursuant to paragraph (c)(5) of this section with respect to any discussions concerning the rejected offer of settlement.

(7) Final acceptance of any offer of settlement will occur only upon the issuance of findings and an order by the Commission.