



PROGRAM MATERIALS

Program #3103

October 12, 2021

Challenging the SEC in Federal Court: Recent Developments in Case Law and Practice Notes

Copyright ©2020 by:

- **Jay Dubow, Esq. - Troutman Pepper Hamilton Sanders LLP**
- **Ghillaine Reid, Esq. - Troutman Pepper Hamilton Sanders LLP**
- **Mary Grace Metcalfe, Esq. - Troutman Pepper Hamilton Sanders LLP**

**All Rights Reserved.
Licensed to Celesq®, Inc.**

Celesq® AttorneysEd Center
www.celesq.com

5255 North Federal Highway, Suite 310, Boca Raton, FL 33487
Phone 561-241-1919 Fax 561-241-1969

Challenging the SEC in Federal Court

Recent Developments in Case Law and Practice

October 12, 2021

These materials and commentary are intended for educational purposes only. No portion may be construed as rendering legal advice for specific cases, or as creating an attorney-client relationship between the audience and the author. The opinions expressed herein are solely those of the author.

Presenters



Ghillaine A. Reid is a partner and co-head of the securities investigations and enforcement practice at Troutman Pepper.



Jay A. Dubow is a partner and co-head of the securities investigations and enforcement practice at Troutman Pepper.



Mary Grace W. Metcalfe is an associate in the securities investigations and enforcement practice at Troutman Pepper.

The SEC's Authority to Investigate Securities Laws Violations

The SEC has broad investigate authority

(a) Authority and discretion of Commission to investigate violations

(1) The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter, the rules or regulations thereunder....The Commission is authorized in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this chapter, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this chapter relates.

15 U.S.C.A. § 78u(a)(1)

Decisions by the SEC's enforcement division to conduct and investigation are discretionary

“Nothing in the '34 Act suggests that the SEC is subject to greater judicial review. Section 21(a)(1), 15 U.S.C. § 78u(a)(1), provides that the ‘Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter’, and § 21(d) adds that when the SEC concludes that someone is ‘engaged or is about to engage in acts or practices constituting a violation ... it may in its discretion bring an action in the proper district court’. Investigation and prosecution under § 21 are discretionary, not mandatory.”

Bd. of Trade of City of Chicago v. S.E.C., 883 F.2d 525, 530–31 (7th Cir. 1989)

“Plaintiffs' harm ultimately stems from the SEC's failure to investigate Madoff and uncover his Ponzi scheme. As a result, the conduct Plaintiffs seek to challenge is “too intertwined with purely discretionary decisions” made by SEC personnel. Despite our sympathy for Plaintiffs' predicament (and our antipathy for the SEC's conduct), Congress's intent to shield regulatory agencies' discretionary use of specific investigative powers via the DFE is fatal to Plaintiffs' claims.”

Molchatsky v. United States, 713 F.3d 159, 162 (2d Cir. 2013)

Consequences of an SEC investigation

After initiating an investigation, the SEC can

- I. file an enforcement action in district court;
- II. bring an administrative proceeding; or
- III. close the investigation without action.

Generally speaking, before acting on items (i) and (ii), the staff will first make a Wells call and offer the potential defendant or respondent the opportunity to submit a Wells response

Thorough and fair review by the SEC is “particularly important when the respondent faces a lifetime bar, which is ‘the securities industry equivalent of capital punishment.’”

Saad v. S.E.C., 718 F.3d 904, 906 (D.C. Cir. 2013)
(quoting *PAZ Sec., Inc. v. S.E.C.*, 494 F.3d 1059, 1065 (D.C. Cir. 2007))

- **There are a number of steps that can be taken at the start of an investigation to simplify or ease a subject's participation**
 - Contact SEC staff assigned to staff to negotiate the scope of the subpoena or participation in investigation
 - Attempt to frame or resolve client's role in the investigation quickly and with as little involvement as possible
 - Collaborative approach
- **Making a request for the Formal Order of Investigation is also standard**

The broad investigative power of the SEC make it difficult to bring legal challenges regarding perceived misconduct during an investigation, such as expressions of animus or retaliatory targeting of subjects

- Heffernan v. Hunter, 189 F.3d 405 (3d Cir. 1999)
- S.E.C. v. Follick, 2002 WL 31833868 (S.D.N.Y. Dec. 18, 2002)
- S.E.C. v. Cuban, 798 F. Supp. 2d 783 (N.D. Tex. 2011)

SEC's Authority to Investigate

Administrative Procedure Act: Review

Under § 702 of the Administrative Procedures Act, sovereign immunity of agencies is waived to provide a right of review.

“A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. The United States may be named as a defendant in any such action, and a judgment or decree may be entered against the United States...”

5 U.S.C.A. § 702

§ 701. Application...

(a) This chapter applies, according to the provisions thereof, except to the extent that--

- 1) statutes preclude judicial review; or
- 2) agency action is committed to agency discretion by law.

5 U.S.C.A. § 701

Securities Exchange Act of 1934 provides for judicial review of subpoenas

(c) Judicial enforcement of investigative power of Commission; refusal to obey subpoena; criminal sanctions

In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof...

15 U.S.C.A. § 78u(c)

Challenges to subpoenas include challenges for abuse of process

“SEC investigations are authorized “in its discretion” by 15 U.S.C. § 78u(a) (1976). The issuance of subpoenas is similarly authorized by 15 U.S.C. § 78u(b) (1976). The initiation of an investigation and issuance of subpoenas are not unreviewable by the federal courts, however, for such subpoenas are unenforceable absent a court order issued under 15 U.S.C. § 78u(c) (1976). Parties who are the subject of such subpoenas are free in a proceeding under that section to raise claims of abuse of process, as Sprecher did in Knopfler.”

Sprecher v. Graber, 716 F.2d 968, 974 (2d Cir. 1983)

Challenge of subpoenas is limited to the subpoenas themselves

“Because an SEC-issued subpoena is unenforceable absent a court order, and the subpoena enforcement proceeding provides an opportunity for judicial review of both an investigation's legitimacy, and a subpoena's legitimacy, the proceeding ‘is the exclusive method by which the validity of SEC investigations and subpoenas may be tested in the federal courts.’ *Sprecher*, 716 F.2d at 974–75. Arjent argues that because subpoena enforcement proceedings under the Exchange Act might not be employed in every investigative action, their existence may not be viewed as precluding review of whether the SEC exceeded its authority or acted in an arbitrary and capricious manner during an investigation.

...

because a subpoena enforcement proceeding would not be an appropriate avenue of review for an equal protection claim, and the SEC has no administrative procedure for raising such a claim, a finding of preclusion would foreclose all judicial review. “

Arjent LLC v. U.S. S.E.C., 7 F. Supp. 3d 378, 384 (S.D.N.Y. 2014)

Guy Gentile's Twelve-Year Relationship with the SEC

Guy Gentile's Background

- **Subject of an SEC investigation concerning penny-stock manipulations in 2007 and 2008**
- **Investigation led to both a criminal and civil case in New Jersey in 2016**
 - *United States v. Gentile*, No. 16-cr-155
 - *SEC v. Gentile*, No. 16-cv-1619
- **Cooperated with the SEC going forward**
- **Cooperation broke down**

- **SEC issued subpoenas related to a separate, ongoing investigation being conducted in Florida to Gentile, Marin (his personal attorney), and (MinTrade Techs., LLC) a business with which he associated**
- **These subpoenas led to two enforcement actions in the Southern District of Florida**
 - *SEC v. Marin, No. 19-mc-20493*
 - *SEC v. MinTrade Techs., LLC, No. 19-mc-20496.*
- **Also led to Gentile filing an action against the SEC in the District of New Jersey, challenging the SEC's investigatory authority more generally**

Gentile v. SEC

No. 19-cv-05155

No. 19-2252

In his Complaint, Gentile alleged

- that the SEC's conduct with regard to the ongoing investigation was "intended solely for the purpose of harassment and to retaliate against [] Gentile for stopping his full-time cooperation with the SEC in 2015" and
- that his career had been "severely harmed" as a result

Gentile sought a court order

- quashing the subpoenas,
- declaring the investigation to be "without statutory authority and an abuse of process", and
- precluding the use of "evidence obtained through [the] misuse" of the investigation

The SEC's Motion to Dismiss

The SEC moved to dismiss Gentile's complaint in its entirety.

Both parties focused heavily on the subpoenas at the motion to dismiss stage, arguing whether Section 21 of the Exchange Act provided the exclusive method for reviewing and challenging subpoenas issued by the SEC, and thus whether Gentile could challenge the subpoenas in Florida through his filing in the District of New Jersey.

The SEC additionally argued that the SEC's investigation constituted an "agency action [] committed to agency discretion by law", and thus was exempt from the APA waiver under 5 U.S.C. § 701(a)(2).

The District Court Opinion

The District Court of New Jersey granted the SEC's motion to dismiss on May 14, 2019, and adopted the same focus on the subpoenas reflected in the parties' pleadings.

Relying on *Sprecher v. Graber*, the court held that

“This Court is persuaded by the well-reasoned decisions in the *Sprecher* cases and their progeny. The parties cite to no case within the Third Circuit either endorsing or rejecting the SEC's argument, and the Court has found no such case in its independent review of the legal landscape. Accordingly, the Court follows the *Sprecher* decisions in concluding that Plaintiff's challenge to the validity of the SEC's investigation outside of an SEC enforcement proceeding under Section 78u(c) is barred by the doctrine of sovereign immunity and is therefore beyond this Court's power to review.”

Gentile v. Sec. & Exch. Comm'n, 2019 WL 2098832, at *4 (D.N.J. May 14, 2019).

In Upholding, the Third Circuit Focused on the Challenge of Authority

“Gentile's complaint challenges only one discrete agency action: the SEC's Formal Order of Investigation of Traders Café. Gentile argues that the Formal Order of Investigation exceeds the SEC's authority because it does not have a sufficient nexus to his conduct and because it allows a retributive investigation. By attacking the Formal Order of Investigation, Gentile seeks to invalidate the entire Traders Café investigation including the administrative subpoenas served in connection with the investigation.

Those administrative subpoenas also constitute a discrete agency action. But Gentile's complaint does not seek to quash those subpoenas based on any attribute of any individual subpoena. Rather, Gentile aspires to undermine the SEC's authority for this investigation – with the consequence of nullifying all subpoenas in the matter. Without challenging any individual subpoena or disputing any other discrete agency action, the only agency action challenged by Gentile's complaint is the SEC's Formal Order of Investigation.”

Gentile v. SEC, 974 F.3d 311, 317-18 (3d Cir. 2020)

The Third Circuit Found the Exception to the APA's Waiver of Immunity

“The § 701(a)(2) exception applies only in ‘those rare circumstances where the relevant statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion.’”

Gentile v. SEC, 974 F.3d 311, 318 (3d Cir. 2020)
(quoting *Lincoln v. Vigil*, 508 U.S. 182, 191 (1993))

“And, without judicially manageable standards to evaluate those considerations, an agency decision to investigate is [] committed to agency discretion by law. Nor has Congress by statute or the SEC by regulation articulated specific standards governing a decision to initiate an investigation under the Exchange Act. Thus, without judicially manageable standards, an agency's decision on whether to investigate is a matter committed to agency discretion by law.”

Gentile v. SEC, 974 F.3d 311, 319 (3d Cir. 2020)

The Third Circuit Distinguished the Case from *Sprecher*

“To defend itself, the SEC leads with the *Sprecher* argument. ... But that argument supposes that Gentile's complaint challenges individual SEC subpoenas. And while Gentile does seek to quash every subpoena, he does so not due to any particularized defect in any subpoena. Rather, he does so by challenging the legality of the Formal Order of Investigation. And by directing his challenge to the SEC's Formal Order of Investigation, Gentile avoids the SEC's *Sprecher* argument, which involved a challenge to individual subpoenas – not solely a direct challenge to the agency's decision to open an investigation. Thus, regardless of whether § 78u(c) of the Exchange Act provides the exclusive mechanism for challenging a subpoena, it does not bar Gentile's challenge to a Formal Order of Investigation.”

Gentile v. SEC, 974 F.3d 311, 318 (3d Cir. 2020)

SEC v. Gentile

No. 16-cv-01619

Meanwhile the SEC's Civil Case Against Gentile Was Still Pending

After years, the SEC filed an Amended Complaint against Gentile in the civil action it had started, seeking an injunction against future violations of the federal securities laws against Gentile.

Gentile moved to dismiss the amended complaint for failure to state a claim upon which relief could be granted.

The SEC, in opposition, sought

- to rely on information not contained in the amended complaint itself, and
- to excuse itself from pleading all the necessary elements for the injunction it sought at this stage.

The District Court Held the SEC to the Applicable Pleading Standards

“the Court is compelled to highlight that this is not the first time the SEC has attempted to rely on factual assertions not contained in the operative complaint. In a September 18, 2017 Opinion and Order, Judge Linares administratively terminated Defendant's motion to dismiss the original complaint and directed the SEC to file an amended complaint. In so doing, the Judge Linares noted that ‘in its opposition brief, the SEC raises examples concerning certain conduct that [Defendant] has engaged in after January 2017 that are not asserted in the complaint. ... As a result, the Court is being asked to engage in the task of addressing a [Rule 12(b)(6) Motion], but the Court does not have the benefit of a straightforward complaint to refer to in determining whether a claim has been stated.’

The SEC appears to be, once again, raising examples of the Defendant's conduct not contained in the Amended Complaint. Such an effort was not previously permitted by the Court, nor will it be permitted now. The Court, accordingly, declines to take judicial notice of the new facts alleged in the SEC's opposition brief. If the SEC wishes the Court to consider these allegations, they must be included in a further amended complaint.”

SEC v. Gentile, 2020 WL 5793699, at *11–12 (D.N.J. Sept. 29, 2020)
(quoting Order and Opinion dated Sept. 18, 2017)

The District Court Held the SEC to the Applicable Pleading Standards

“The SEC argues the Court cannot make a determination as to the propriety of the sought injunctions at this stage because it can only make such a decision upon consideration of a developed factual record. While this is an accurate statement of the general standard governing the issuance of injunctions, the SEC omits, or at least fails to acknowledge, that their complaint must still state a plausible claim for relief. Despite accepting the facts alleged as true, and drawing reasonable inferences in the SEC's favor, the Court concludes the SEC has not stated such a claim.”

***SEC v. Gentile*, 2020 WL 5793699, at *13 (D.N.J. Sept. 29, 2020)**

“While the SEC is not required to make an evidentiary showing to survive a motion to dismiss, they must still include sufficient allegations to plausibly state an entitlement to relief.”

***SEC v. Gentile*, 2020 WL 5793699, at *14 (D.N.J. Sept. 29, 2020)**

***SEC v. Marin &
SEC v. MinTrade Technologies, LLC***

No. 19-mc-20493

No. 19-mc-20496

No. 19-13990

Most Recently, the Eleventh Circuit Heard the Marin and MinTrade Appeals

Carla Marin, Gentile's attorney, and MinTrade Technologies, LLC, a company affiliated with Gentile, were the subject of actions to enforce subpoenas served upon them in the ongoing Florida investigation.

Both were ordered to comply by the Southern District of Florida, and both appealed.

In light of the shared facts, underlying investigation, legal arguments, and representation, the cases were heard together on appeal.

The Eleventh Circuit Reiterates an Agency's Subpoena Obligations

“To obtain judicial enforcement of an administrative subpoena, an agency such as the SEC must establish four things: ‘[1] that the investigation will be conducted pursuant to a legitimate purpose, [2] that the inquiry may be relevant to the purpose, [3] that the information sought is not already within the [agency's] possession, and [4] that the administrative steps required ... have been followed...’ All the agency must do in the first instance is make out a prima facie showing that the *Powell* criteria are met.”

***SEC v. Marin*, 2020 WL 7332685, at *6 (11th Cir. Dec. 14, 2020)
(quoting *United States v. Powell*, 379 U.S. 48 (1964))**

The SEC's Purpose Means *Powell* Is Easily Met

“The SEC issued the Marin and MinTrade subpoenas pursuant to a legitimate investigative purpose. The SEC enjoys broad, discretionary power to investigate past, ongoing, or imminent violations of the Exchange Act. The SEC's investigatory power is analogous to the power of a grand jury, ‘which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.’ This power is not without limits: ‘a governmental investigation ... may be of such a sweeping nature and so unrelated to the matter properly under inquiry as to exceed the investigatory power.’ Still, “it is sufficient if the inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant.”

SEC v. Marin, 2020 WL 7332685, at *6 (11th Cir. Dec. 14, 2020)
(quoting *United States v. Fla. Azalea Specialists*, 19 F.3d 620, 622 (11th Cir. 1994)
& *United States v. Morton Salt Co.*, 338 U.S. 632, 642–43 (1950))

The SEC's Purpose Means *Powell* Is Easily Met

“The SEC's investigative powers are not limited to the specific entities named in a formal order.

...

Congress's broad grant of investigative authority to the SEC does not contemplate a game of cat and mouse whereby the SEC must issue another formal order of investigation each time an investigation yields a new lead.”

***SEC v. Marin*, 2020 WL 7332685, at *7 & 8 (11th Cir. Dec. 14, 2020)**

Best Practices in Challenging an Investigation

Avoid a direct challenge regarding the investigation

- **As noted in *Gentile v. Sec. & Exch. Commission*, there is no basis for the judicial review of the SEC's investigatory decisions**
- **Therefore, litigants may not bring direct challenges regarding the SEC's authority to conduct an investigation**
- **Any change would require clarification by Congress or the SEC regarding the acceptable standards and bases for the initiation or continuation of an investigation**

Wait until the SEC Submits itself to Review of Court

“Plaintiff will have an opportunity and a forum in which to challenge the Florida investigation's legitimacy when or if the SEC seeks some judicial intervention as to him—*i.e.*, a subpoena enforcement proceeding under Section 78u(c) or a civil enforcement action under Section 78u(d).”

***Gentile v. SEC*, 2019 WL 2098832, at *6 (D.N.J. May 14, 2019)**

“The proper arena for plaintiff's challenge to the SEC's use of the Siegal Email will be the enforcement action, if any, brought by the SEC against plaintiff.”

***Finazzo v. S.E.C.*, 2008 WL 3521351, at *4 (S.D.N.Y. Aug. 8, 2008),
aff'd, 360 F. App'x 169 (2d Cir. 2009)**

Focus on areas squarely within the court's jurisdiction

- **Statute provides for challenges of a subpoena during the course of an investigation**
- **Federal Rules of Civil Procedure and the Federal Rules of Evidence provide the guidelines for challenging SEC conduct in using the fruits of their investigation**
- **Take advantage of protections afforded all litigants**



Thank You

These materials and commentary are intended for educational purposes only. No portion may be construed as rendering legal advice for specific cases, or as creating an attorney-client relationship between the audience and the author. The opinions expressed herein are solely those of the author.



Portfolio Media, Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Ex-Informant Ruling Guides On Challenging SEC Enforcement

By **Jay Dubow, Mary Grace Metcalfe and Ghillaine Reid** (November 18, 2020, 5:26 PM EST)

On Sept. 29, the U.S. District Court for the District of New Jersey issued an order in the matter U.S. Securities and Exchange Commission v. Gentile **dismissing** the amended complaint filed by the SEC seeking an injunction against former government informant Guy Gentile.

This decision, which is the most recent in several matters over many years involving both Gentile and the SEC, offers useful guidance to those facing an SEC enforcement action. Particularly, when compared to the recent U.S. Court of Appeals for the Third Circuit **decision** in Gentile v. SEC, another matter involving the same parties, the District of New Jersey's opinion in SEC v. Gentile highlights the protections afforded to the certain subjects of SEC investigations once the investigation results in litigation.



Jay Dubow

On Sept. 10, the Third Circuit issued its decision in Gentile v. SEC, in which it determined that the authority to investigate had been committed to the SEC's discretion by law, without any meaningful standard of review, and thus that the SEC's decision to investigate is exempt from the waiver of sovereign immunity that might otherwise apply under the Administrative Procedure Act. [1]



Mary Grace Metcalfe

In contrast to the challenges raised in Gentile v. SEC, which focused on the SEC's exercise of its unique authority, Gentile's challenges in this matter focused on the SEC's conduct as a litigant. The recent ruling by the District of New Jersey focused on the remedy sought by the SEC's action, rather than the conduct at issue, and thus provides guidance on how certain defendants can challenge SEC enforcement actions, once they are in the court system.

After the SEC commenced the litigation seeking an injunction against future violations of the federal securities laws against Gentile, Gentile moved to dismiss the SEC's amended complaint for failure to state a claim upon which relief can be granted.

The SEC's counterarguments effectively sought to avoid the application of the Federal Rules of Civil Procedure by excusing it both from pleading all the elements of its claim and doing so within the four corners of the complaint.



Ghillaine Reid

The SEC argued that, despite the existence of a securities law violation within the relevant time period being a necessary element of the injunction at issue, the evaluation of such element could not be made by the district court at the motion to dismiss stage. Such a determination, it argued, could only be made upon review of "a full evidentiary record." [2]

These arguments, in effect, sought to excuse the SEC from meeting the applicable pleading standards imposed by the Federal Rules of Civil Procedure.

The District of New Jersey rejected each of the SEC's arguments and instead focused on the deficiency of the SEC's pleadings, in light of the requested relief. The district court declined to take judicial notice of the new facts pled in opposition to the motion to dismiss.

In so declining, the district court drew attention to the SEC's past pleadings in the case, noting that "the Court is compelled to highlight that this is not the first time the SEC has attempted to rely on factual assertions not contained in the operative complaint" and "such an effort was not previously permitted by the Court, nor will it be permitted now." [3]

Like any other litigant, should the SEC wish to bring additional factual allegations to the court's attention, it would need to do so by amending its complaint. [4]

The district court similarly rejected the SEC's argument regarding its claim for an injunction, reminding the agency of its obligations as a litigant in federal court:

The SEC argues the Court cannot make a determination as to the propriety of the sought injunctions at this stage because it can only make such a decision upon consideration of a developed factual record. While this is an accurate statement of the general standard governing the issuance of injunctions, the SEC omits, or at least fails to acknowledge, that their complaint must still state a plausible claim for relief.

The district court accordingly reviewed the applicable standards for issuing an injunction, including the requirement that "the SEC must plausibly allege Defendant will engage in future securities violations absent an injunction" and evaluated the allegations contained in the amended complaint in light of those requirements. [5]

In particular, the district court noted the disconnect between the conduct pled by the SEC, which was decades old, and the requested relief, which sought to curtail future acts by Gentile.

The district court ultimately found that the "specific facts alleged by the SEC to support this conclusion ... are somewhat feeble" and even "suspect," especially in light of the parties' agreement that Gentile had "not engaged in illegal securities activity for over a decade." [6]

Contrasting this pleading deficiency with the impact that such an injunction would have on a member of the securities industry, the court held:

While the SEC is not required to make an evidentiary showing to survive a motion to dismiss, they must still include sufficient allegations to plausibly state an entitlement to relief. Here, even with all inferences drawn in the SEC's favor, the allegations of the Amended Complaint are insufficient to state a plausible claim for relief. The Court, accordingly cannot even consider whether to impose the "securities industry equivalent of capital punishment." [7]

The district court then granted Gentile's motion to dismiss.

The interplay between the Third Circuit's decision in early September and the District of New Jersey's decision a few weeks later is clear: While the judiciary may not have the ability to review the decisions of the SEC regarding the initiation or continuation of an investigation, once that investigation results in an enforcement action in federal court, the SEC is subject to the federal rules and judicial review.

As a result, and as seen here, the SEC is obligated to adhere to the same procedural standards as any other litigant, including with regard to the initiation of a case and the sufficiency of its pleadings.

Thus, while the subject of an SEC investigation may be limited in his or her recourse with regard to an investigation's existence or continuance, should the SEC proceed to use the fruits of its investigation against the subject in a court of law, that subject has full access to the various rights and protections afforded by our legal system in challenging the agency.

Other recent U.S. Supreme Court and appellate court decisions have put restrictions on the SEC's ability to obtain an injunction. Combined with the District of New Jersey's holding in *Gentile*, these decisions show that when the SEC files suit, defendants may be able to get the case dismissed on a


motion early in the case, under the right circumstances.

Jay A. Dubow is a partner and co-head of the the securities investigations and enforcement practice at Troutman Pepper.

Mary Grace W. Metcalfe is an associate at the firm.

Ghillaine A. Reid is a partner and co-head of the firm's securities investigations and enforcement practice.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] [Gentile v. Sec. & Exch. Comm'n](#) , No. 19-2252, 2020 WL 5416297 (3d Cir. Sept. 10, 2020).

[2] [Sec. & Exch. Comm'n v. Gentile](#), 16-cv-01619-BRM-JAD, Doc. 84 at 9.

[3] [Sec. & Exch. Comm'n v. Gentile](#), 16-cv-01619-BRM-JAD, Doc. 108 at 24.

[4] The district court, in dismissing the amended complaint, noted that it would permit the SEC "one final opportunity to amend their complaint." [Sec. & Exch. Comm'n v. Gentile](#), 16-cv-01619-BRM-JAD, Doc. 108 at 31. On Oct. 19, 2020, the SEC filed a letter to the court confirming that it would "not file a further amended complaint in this matter." *Id.*, Doc. 113. The case was ordered closed on Oct. 21, 2020. *Id.*, Doc. 114.

[5] [Sec. & Exch. Comm'n v. Gentile](#), 16-cv-01619-BRM-JAD, Doc. 108 at 29.

[6] [Sec. & Exch. Comm'n v. Gentile](#), 16-cv-01619-BRM-JAD, Doc. 108 at 29-30.

[7] [Sec. & Exch. Comm'n v. Gentile](#), 16-cv-01619-BRM-JAD, Doc. 108 at 31 (quoting [Saad v. S.E.C.](#), 718 F.3d 904, 906 (D.C. Cir. 2013)).

All Content © 2003-2020, Portfolio Media, Inc.



Portfolio Media, Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Gov't Informant Ruling Will Limit Recourse For SEC Targets

By **Jay Dubow, Mary Grace Metcalfe and Ghillaine Reid** (October 7, 2020, 4:56 PM EDT)

On Sept. 10, the U.S. Court of Appeals for the Third Circuit upheld the dismissal of claims brought in the U.S. District Court for the District of New Jersey by Guy Gentile against the U.S. Securities and Exchange Commission for abuse of process related to a separate, ongoing investigation.

In so holding, however, the Third Circuit departed from the analysis concerning lack of subject matter jurisdiction that provided the basis for the district court's opinion. Instead, the Third Circuit held that the decision to investigate had been committed to the SEC's discretion by law and thus that the SEC's decision to investigate was exempt from the waiver of sovereign immunity that might otherwise apply under Section 702 of the Administrative Procedure Act.

As a result, the decision in *Gentile v. SEC* effectively forecloses subjects of an SEC investigation from directly challenging the agency's decision to commence or continue an investigation in the Third Circuit.

As the Third Circuit noted at the outset of its opinion, plaintiff-appellant "Guy Gentile and the Securities and Exchange Commission are not strangers."^[1] Gentile had previously been the subject of an SEC investigation concerning penny-stock manipulations in 2007 and 2008, which ultimately spawned both civil and criminal proceedings in the District of New Jersey in 2016.^[2]

In 2016 and 2017, Gentile also received subpoenas related to a separate, ongoing investigation conducted by the SEC in Florida, in which individuals and entities associated with Gentile, including his personal attorney, were also subpoenaed.^[3]

In addition to seeking to intervene in the enforcement actions related to the subpoenas in Florida, Gentile filed a complaint in the District of New Jersey in February 2019, commencing the action from which the appeal to the Third Circuit was taken. Rather than focusing on one particular aspect or means of the investigation, Gentile more broadly alleged that the SEC's most recent investigation of his conduct, in its entirety, was in bad faith and a retaliatory abuse of process.^[4]

The SEC moved to dismiss Gentile's complaint on the basis of sovereign immunity. Gentile argued that sovereign immunity was waived pursuant to Section 702 of the APA, which specifically permits suits "seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority."^[5]

The SEC argued that the waiver contained in the APA, which specifically states that "nothing herein affects other limitations on judicial review," did not apply to Gentile's claim because Section 21 of the Securities Exchange Act, provided the exclusive method for reviewing and challenging subpoenas issued by the SEC.



Jay Dubow



Mary Grace Metcalfe



Ghillaine Reid

The SEC additionally argued that the SEC's investigation constituted an agency action "committed to agency discretion by law," and thus was exempt from the APA waiver under Title 5 of the U.S. Code, Section 701(a)(2).

The district court granted the SEC's motion to dismiss, but in doing so focused on the subpoenas that had been issued in Florida and relied heavily on the case *Sprecher v. Graber*, in which the U.S. Court of Appeals for the Second Circuit held that a plaintiff's claims challenging a subpoena issued by the SEC fell "within the proviso to Section 702 preserving existing limitations on judicial review," and thus were "barred by sovereign immunity."^[6]

Having found that the plaintiff's "challenge to the validity of the SEC's investigation outside of an SEC enforcement proceeding under Section 78u(c) is barred by the doctrine of sovereign immunity and is therefore beyond this Court's power to review,"^[7] the district court did not address the SEC's argument under Section 701(a)(2).^[8]

On appeal, the Third Circuit affirmed the dismissal for lack of subject matter jurisdiction but, in doing so, did not adopt the district court's reliance on *Sprecher*. Rather, the Third Circuit distinguished the two cases, noting that:

[W]hile Gentile does seek to quash every subpoena, he does so not due to any particularized defect in any subpoena. Rather, he does so by challenging the legality of the Formal Order of Investigation. And by directing his challenge to the SEC's Formal Order of Investigation, Gentile avoids the SEC's *Sprecher* argument, which involved a challenge to individual subpoenas — not solely a direct challenge to the agency's decision to open an investigation. Thus, regardless of whether § 78u(c) of the Exchange Act provides the exclusive mechanism for challenging a subpoena, it does not bar Gentile's challenge to a Formal Order of Investigation.^[9]

Instead, the court focused on the broad and direct nature of Gentile's challenge and based its opinion on the SEC's alternative argument concerning the exception to the APA waiver found in Section 701(a)(2).

Gentile's broad challenge of the SEC's investigation required the Third Circuit to turn to the statute which granted the SEC the authority to investigate,^[10] rather than the statutory provisions for the review of subpoenas that were at issue in the district court's decision. Noting that the exception to the APA's waiver of sovereign immunity "only applies in 'those rare circumstances where the relevant statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion',"^[11] the Third Circuit accordingly held that:

[W]ithout judicially manageable standards to evaluate those considerations, an agency decision to investigate is ... committed to agency discretion by law. Nor has Congress by statute or the SEC by regulation articulated specific standards governing a decision to initiate an investigation under the Exchange Act. Thus, without judicially manageable standards, an agency's decision on whether to investigate is a matter committed to agency discretion by law.^[12]

Put simply, the SEC's decision to investigate is one of the rare circumstances in which the exception applies.

The Third Circuit further explained that it considered the SEC's decision to investigate analogous to other rare circumstances in which the U.S. Supreme Court has applied the exception under Section 701(a)(2). In support of this position, the Third Circuit specifically cited a number of opinions addressing other agency decisions, including:

- The U.S. Food and Drug Administration's decision not to prosecute under the Federal Food, Drug and Cosmetic Act;
- A decision "implicating intelligence and national security concerns" by the Central Intelligence Agency; and

- Decisions involving "the spending of lump-sum appropriations" by the Indian Health Service, an agency within the Public Health Service of the U.S. Department of Health and Human Services charged with spending such lump sums.[13]

As the Supreme Court has made clear in such cases, a holding applying the exception under Section 701(a)(2) "essentially leave[s] to Congress, and not to the courts, the decision as to whether an agency's [action] should be judicially reviewable." [14]

In addition to the consistent holdings, the Third Circuit's choice of cases and decisions sheds further light on the court's reasoning. Each of the agency decisions that the Third Circuit chose to use as an example is closely related to the agency's mission and the purpose for which it was formed, and this relationship between the decision and the agency's purpose is further highlighted by the description of the decision the court provided.[15]

Thus, while not explicitly addressed as a consideration, the fact that the investigation of potential securities violations has been one of the central purposes of the SEC since its inception almost certainly factored into the Third Circuit's analysis.[16]

The application of this exception accordingly forecloses piecemeal challenges based on the nature or underlying motives of the alleged abuse of the SEC's investigative powers. While the Third Circuit acknowledged the scope and gravity of harms that may result from an SEC investigation, it concluded that the exception under Section 701(a)(2) "shields the entirety of an agency action that is committed to agency discretion by law," and that a "litigant cannot, therefore, avoid the exception by challenging only the most problematic component of an agency action." [17]

Although the distinction the Third Circuit drew with regard to the decision in *Sprecher* reaffirms the process for challenging individual subpoenas issued by the SEC, the holding in *Gentile v. SEC* ultimately means that, absent clarification by Congress or the SEC regarding the acceptable standards and bases for the initiation or continuation of an investigation, the SEC's decisions to investigate, or not, are not subject to judicial review.


As a result, subjects of an SEC investigation have no recourse to directly challenge the SEC's decision to investigate them in court. Thus, a subject of an SEC investigation who wants to challenge the investigation will need to either challenge a specific subpoena issued during the investigation or raise the concerns regarding the investigation in response to an enforcement action, if any is brought. Of course, the bar to make such challenges is very high.

Jay A. Dubow is a partner and co-head of the the securities investigations and enforcement practice at Troutman Pepper.

Mary Grace W. Metcalfe is an associate at the firm.

Ghillaine A. Reid is a partner and co-head of the firm's securities investigations and enforcement practice.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.


[1] *Gentile v. Sec. & Exch. Comm'n* , No. 19-2252, 2020 WL 5416297, at *1 (3d Cir. Sept. 10, 2020).

[2] See *United States v. Gentile*, No. 16-cr-155 & *SEC v. Gentile*, No. 16-cv-1619.

[3] See *SEC v. Marin*, No. 19-mc-20493& *SEC v. MinTrade Techs., LLC*, No. 19-mc-20496.

[4] *Gentile v. SEC* , No. 19-cv-05155.

[5] 5 U.S.C. § 702.

[6] *Sprecher v. Graber* , 716 F.2d 968, 974 (2d Cir. 1983).

[7] *Gentile v. Sec. & Exch. Comm'n*, No. 19-cv-05155, 2019 WL 2098832, at *4 (D.N.J. May 14, 2019), *aff'd*, No. 19-2252, 2020 WL 5416297 (3d Cir. Sept. 10, 2020).



[8] *Gentile v. Sec. & Exch. Comm'n*, No. 19-cv-05155, 2019 WL 2098832, at *6 n5 (D.N.J. May 14, 2019), *aff'd*, No. 19-2252, 2020 WL 5416297 (3d Cir. Sept. 10, 2020).

[9] *Gentile v. Sec. & Exch. Comm'n*, No. 19-2252, 2020 WL 5416297, at *5 (3d Cir. Sept. 10, 2020) (quoting 5 U.S.C. § 701(a)(2)).

[10] 15 U.S.C. § 78u(a) ("The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provisions.") & 17 C.F.R. § 200.66 ("The requirements of the particular case alone should induce the exercise of the [SEC's] investigatory power").

[11] *Gentile v. Sec. & Exch. Comm'n*, No. 19-2252, 2020 WL 5416297, at *5 (3d Cir. Sept. 10, 2020).

[12] *Gentile v. Sec. & Exch. Comm'n*, No. 19-2252, 2020 WL 5416297, at *6 (3d Cir. Sept. 10, 2020).

[13] *Gentile v. Sec. & Exch. Comm'n*, No. 19-2252, 2020 WL 5416297, at *5-6 (3d Cir. Sept. 10, 2020) (citing *Heckler v. Chaney*, 470 U.S. 821 (1985); *Webster v. Doe* , 486 U.S. 592 (1988); and *Lincoln v. Vigil* , 508 U.S. 182 (1993), respectively).

[14] *Heckler v. Chaney* , 470 U.S. 821, 838 (1985).

[15] Compare description of decisions in *Heckler v. Chaney*, 470 U.S. 821 (1985); *Webster v. Doe*, 486 U.S. 592 (1988); and *Lincoln v. Vigil*, 508 U.S. 182 (1993), with 21 U.S.C. § 301 et seq.; 50 U.S.C. § 44, et seq.; & 25 U.S.C. § 13; respectively.

[16] See Securities Exchange Act of 1934, § 21; 15 U.S.C. § 78u.

[17] *Gentile v. Sec. & Exch. Comm'n*, No. 19-2252, 2020 WL 5416297, at *6 (3d Cir. Sept. 10, 2020).