

## Gov't Informant Ruling Will Limit Recourse For SEC Targets

By Jay Dubow, Mary Grace Metcalfe and Ghillaine Reid (October 7, 2020)

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.



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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."<sup>[6]</sup>

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,"<sup>[7]</sup> the district court did not address the SEC's argument under Section 701(a)(2).<sup>[8]</sup>

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.<sup>[9]</sup>

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,<sup>[10]</sup> 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',"<sup>[11]</sup> 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.<sup>[12]</sup>

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.

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[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).