

U.S. Supreme Court Decision Limits SEC's Ability to Use Administrative Proceedings in Fraud Cases

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The U.S. Supreme Court held that when the Securities and Exchange Commission (SEC) seeks civil penalties against a defendant for securities fraud, the Seventh Amendment of the U.S. Constitution entitles the defendant to a jury trial and the SEC must bring the action in federal court. *Securities and Exchange Comm'n v. Jarkesy*, No. 22-859 (June 27, 2024). The 6-3 decision ends the SEC's long-running use of in-house tribunals before SEC administrative law judges (ALJs) to adjudicate fraud actions.

This opinion came one day before the Court overturned the decades-old *Chevron* doctrine of judicial deference to a federal agency's interpretation of an ambiguous statute. *Loper Bright Enters. v. Raimondo*, No. 22-451, and *Relentless, Inc. v. Department of Commerce*, No. 22-1219 (June 28, 2024).

Background

In 2013, the SEC charged George Jarkesy and his firm with securities fraud. After an evidentiary hearing before an ALJ, Jarkesy was found liable and ordered to pay \$300,000 in civil monetary penalties. Jarkesy sought review of the SEC's decision in the U.S. Court of Appeals for the Fifth Circuit.

The Fifth Circuit reversed and remanded the matter, finding that: (1) the SEC's use of an ALJ to adjudicate the claims violated Jarkesy's Seventh Amendment right to a jury trial; (2) Congress had unconstitutionally delegated legislative power to the SEC by failing to provide it with an intelligible principle by which to exercise the delegated power; and (3) the statutory removal restrictions on SEC ALJs violate separation-of-powers principles under Article II of the Constitution.

The Supreme Court granted *certiorari* on all three issues, but ultimately decided the matter on Seventh Amendment grounds.

U.S. Supreme Court Decision

The Court evaluated whether Jarkesy's right to trial by jury was implicated in the SEC charges, explaining the Seventh Amendment extends to any statutory claim that is "legal in nature," even where those statutory claims are brought by the government. The Court evaluated the remedy the SEC sought against Jarkesy — civil monetary penalties — and factors such as "culpability, deterrence, and recidivism" to determine that they are remedies aimed at punishing or deterring defendants, rather than compensating victims. The Court ultimately reasoned that the type of remedy sought is a "prototypical common law remedy," making clear the SEC's action was legal in nature (as opposed to an action in equity under which no constitutional jury right is afforded) and is "all but dispositive" in the Seventh Amendment analysis.

The Court further concluded that the "public rights exception" to Article III jurisdiction did not permit the SEC to bypass the jury. This exception, the Court said, could apply to

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matters that “historically could have been determined exclusively by the executive and legislative branches” such as revenue collection, immigration, tariffs, tribal relations, the administration of public lands, and the granting of public benefits. Unlike in those examples, the Court explained, the SEC’s suit intended to target “the same basic conduct as common law fraud,” which amounts to a “matter[] of private rather than public right.” Even where Congress has plenary power over the subject matter, the Court stressed, the public rights exception should not be applied in broad strokes — it is, “after all, an *exception*”— but through a case-specific approach that draws “close attention to the basis for each asserted application of the doctrine.”

Implications

The Court’s ruling may have significant and far-reaching implications. As an initial matter, the decision was a partial rejection of the SEC’s administrative forum. *Jarkesy* may cause the SEC to become more selective in choosing to bring enforcement actions.

The decision also makes way for a wide range of potential constitutional challenges to agency administrative actions, including:

- Whether a claim for civil penalties that implicates the right to a jury trial nonetheless falls within the “public rights” exception;
- Whether an agency’s claim for fraud, brought administratively, implicates the right to a jury trial, regardless of whether penalties are sought; and
- Whether other types of claims brought within an administrative forum implicate the right to a jury trial.

Furthermore, because the Supreme Court affirmed the Fifth Circuit ruling only as to the Seventh Amendment violation and did not address the two other holdings, these questions likely will continue to be litigated in other forums. (The Fifth Circuit had also held that Congress violated the nondelegation doctrine by delegating the authority to enforce securities laws to the SEC and that legal restrictions on the ability of Executive Branch officials to remove ALJs, which allow dismissals only when they are “for cause,” violated separation-of-powers principles under Article II of the Constitution.)

Finally, the Court’s reasoning in *Jarkesy* is expected to have consequences beyond the SEC. Justice Sonia Sotomayor stressed in her dissent that “momentous consequences” likely flow from “the majority’s insistence that the Government’s rights to civil penalties must now be tried before a jury in federal court.” She noted Congress has enacted numerous new statutes empowering federal agencies to impose penalties for statutory violations, and there are “more than two dozen agencies” that impose civil penalties in administrative proceedings. At least nine federal agencies face pending challenges to in-house adjudications like that of the SEC:

- Consumer Protection Safety Commission
- FDIC
- Immigration and Nationality Act claims handled by Department of Justice’s Office of the Chief Administrative Hearing Officer
- NLRB
- National Credit Union Administration
- FTC

- FCC
- USDA
- Department of Labor

With respect to the Department of Labor, the 2002 Sarbanes-Oxley Act, a federal law to protect investors by preventing fraudulent practices at publicly traded companies as well as whistleblowers who report potential violations of securities laws, mandates the use of administrative hearings through the Department of Labor, Occupational Safety and Health Administration. *Jarkesy* may impact the use of these administrative hearings, as these proceedings may be perceived as an agency enforcement action for civil penalties based on common-law-type fraud claims, which now must be brought in a federal court, where the defendant has a right to a jury trial and all the other procedural safeguards that come with civil litigation.

Companies and their counsel will need to carefully assess how *Jarkesy* might apply to other laws enforced by federal agencies, considering each statute individually as litigations progress.

Please contact a Jackson Lewis attorney with any questions.

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