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Supreme Court: SEC Fraud Actions for Civil Penalties Must Be Brought in Federal Court

Court Holds That Defendants Have Seventh Amendment Right to Jury Trial in Fraud Actions Brought by SEC Under Securities Act, Exchange Act, and Advisers Act

SUMMARY

The U.S. Supreme Court ruled yesterday in *Securities and Exchange Commission v. Jarkesy* that, absent the defendant's consent, the SEC must bring securities-fraud actions seeking civil penalties before a federal court, rather than before the agency's in-house adjudicators. In a 6-3 decision authored by Chief Justice Roberts, the Court affirmed the Fifth Circuit's decision, holding that the Seventh Amendment entitles defendants to a jury trial and that the "public rights" exception to the Amendment does not apply.

BACKGROUND

In response to the Wall Street Crash of 1929, Congress enacted the Securities Act of 1933 (Securities Act), the Securities Exchange Act of 1934 (Exchange Act), and the Investment Advisers Act of 1940 (Advisers Act).¹ All three statutes contain antifraud provisions, which prohibit misrepresentations and concealment of material facts in certain circumstances.² The SEC is authorized to enforce each provision in one of two ways: by filing suit in federal court, or by initiating an enforcement action before the Commission itself.³ A proceeding before the SEC does not involve a jury. Instead, the Commission or an administrative law judge (ALJ) presides and finds facts, while the Division of Enforcement prosecutes the case. Federal evidence and discovery rules do not apply. A finding of fact may be appealed to a federal court, but the court's review is deferential.⁴

Before 2010, the SEC could seek civil penalties only by bringing a federal lawsuit; such penalties were not available in an administrative proceeding. The Dodd-Frank Act, however, authorized the Commission to impose civil penalties in an in-house adjudication.⁵

In 2013, the SEC initiated an enforcement action against George Jarquesy and his investment fund, alleging violations of the antifraud provisions of the Securities Act, the Exchange Act, and the Advisers Act.⁶ The Commission opted for proceedings before an ALJ. In 2020, the Commission issued a final order imposing a civil penalty of \$300,000, among other remedies.⁷ On review, the Fifth Circuit ruled for Jarquesy and vacated the order on three separate constitutional grounds. First, it held that the SEC's decision to adjudicate the matter in-house violated Jarquesy's Seventh Amendment right to a jury trial. Second, it held that Congress had violated the nondelegation doctrine when it authorized the SEC, without adequate guidance, to choose either in-house or federal-court proceedings for its enforcement actions. Third, it held that SEC ALJs enjoy an unconstitutional level of protection from removal by the President.⁸ The Supreme Court granted certiorari on all three issues.⁹

THE SUPREME COURT'S DECISION

The Supreme Court addressed only the Fifth Circuit's Seventh Amendment decision, and affirmed. The Court held that (i) the SEC's choice to pursue civil penalties for violation of the antifraud provisions implicated Jarquesy's Seventh Amendment rights; and (ii) the case did not come within the "public rights" exception, under which Congress may assign to an agency a claim that otherwise must be heard by a jury.¹⁰

In finding that the Seventh Amendment applied, the Court explained that the jury-trial right extends to statutory claims that are "legal in nature."¹¹ To determine if a claim qualifies, the Court examines whether it resembles a common law cause of action and whether the remedy it provides was traditionally available at common law.¹² Starting with the latter, the Court stated that a civil penalty is legal in nature "if it is designed to punish or deter the wrongdoer."¹³ Examining the statutory criteria that guide the availability and amount of the fraud penalties here, the Court found that they tracked the "perceived need to punish the defendant rather than to restore the victim," and thus were "legal rather than equitable."¹⁴ The Court also noted the "close relationship" between "common law fraud" and the antifraud provisions at issue.¹⁵

The Court then held that the case does not come within the "public rights" exception. "Public rights" cases, the Court explained, are matters which "historically could have been determined exclusively by [the executive and legislative] branches."¹⁶ Examples include the collection of tax revenue and administration of public lands. The Court declined to "definitively explain[]" the "distinction between public and private rights," but emphasized that public rights are the "exception."¹⁷ It then held that the SEC antifraud provisions involve *private* rights because they are, "in substance," "akin to" suits at common law: they authorize common law-type remedies, "target the same basic conduct as common law fraud, employ the same terms of art, and operate pursuant to similar legal principles."¹⁸ The Court rejected the government's argument that the presence of the SEC as the plaintiff was sufficient to make this a public rights case.¹⁹ It also distinguished the Court's prior decision in *Atlas Roofing*,²⁰ which allowed the Occupational Safety and Health Review Commission to adjudicate civil-penalty claims involving violations of workplace-safety

regulations. Unlike the securities laws at issue here, the Court explained, the Occupational Safety and Health Act had “create[d] a new cause of action” and “remedies therefor[e] unknown to the common law.”²¹

Justice Gorsuch concurred, in an opinion joined by Justice Thomas. In his view, the Court’s decision was required not only by the Seventh Amendment, but also by the Due Process Clause and Article III.²²

Justice Sotomayor dissented, in an opinion joined by Justices Kagan and Jackson. Arguing that the Court had all but overturned *Atlas Roofing*, Justice Sotomayor wrote that “Congress has broad latitude to create statutory obligations” backed up by civil penalties and to “assign their enforcement outside the regular courts of law where there are no juries.”²³ Under that principle, Justice Sotomayor would have permitted the SEC to pursue civil penalties for fraud claims before an in-house adjudicator.

IMPLICATIONS

The direct takeaway from *Jarkesy* is that, absent consent, the SEC may no longer bring fraud claims under the Securities Act, Exchange Act, or Advisers Act before an in-house adjudicator if it intends to seek civil penalties. Instead, it must file a lawsuit in federal court. Practically, the impact of that holding is limited because the SEC has not used administrative proceedings to pursue fraud claims since 2016.

Beyond that, much remains undecided. The Court’s opinion does not address whether an SEC proceeding seeking only other remedies, such as disgorgement, triggers the Seventh Amendment. (At one point, the Court notes that the power to “order a defendant to return unjustly obtained funds” has its roots in equity,²⁴ which could cut against a jury-trial requirement.) The Court also did not address how its ruling might apply to other statutes administered by other federal agencies. As Justice Sotomayor pointed out in her dissent, “there are, at the very least, more than two dozen agencies that can impose civil penalties in administrative proceedings” under their governing statutes.²⁵ The Court’s decision not to overrule *Atlas Roofing* altogether might indicate that it does not intend to invalidate all of these regimes. The analysis in future cases will likely depend on the particulars of the relevant statute, down to the factors that govern the availability of civil penalties and the similarities (or lack thereof) between the statute and any historical analog. Such cases may come up quickly: at least nine different federal agencies currently face pending challenges to the constitutionality of in-house adjudications.

Finally, it is worth noting that the Court chose not to reach the other two issues on which it granted certiorari. In particular, the Court did not address whether SEC ALJs enjoy an unconstitutional level of protection from removal. The uncertainty over that issue is one of the reasons the SEC has not brought fraud claims before its ALJs since 2016. Many commentators assume that these removal challenges will eventually be successful, resulting in another ruling that could have significant implications for the administrative state.

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ENDNOTES

- 1 15 U.S.C. §§ 77a *et seq.*, 78a *et seq.*, 80b-1 *et seq.*
- 2 15 U.S.C. § 77q(a)(2); 17 CFR § 240.10b-5; 15 U.S.C. § 78j(b); 17 CFR §§ 275.206(4)-8(a)(1), (2);
15 U.S.C. § 80b-6(4).
- 3 15 U.S.C. §§ 77h-1, 78u-2, 78u-3, 80b-3 (agency); 15 U.S.C. §§ 77t, 78u, 80b-9 (court).
- 4 *SEC v. Jarkesy*, 603 U.S. ___, ___ (2024) (slip op., at 3-4).
- 5 See Dodd-Frank Act, § 929P(a), 124 Stat. 1862-1864 (codified in relevant part as amended at 15
U.S.C. §§ 77h-1(g), 78u-2(a), 80b-3(i)(1)).
- 6 *Jarkesy*, 603 U.S. at ___ (slip op., at 5).
- 7 *Id.*
- 8 *Id.* at 5-6 (citing *Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022)).
- 9 *Id.*
- 10 *Id.*
- 11 *Id.* at 8.
- 12 *Id.* at 9.
- 13 *Id.* (internal quotation marks omitted).
- 14 *Id.* at 10-11.
- 15 *Id.* at 11-12.
- 16 *Id.* at 14-17.
- 17 *Id.* at 17.
- 18 *Id.* at 20-21.
- 19 *Id.* at 22.
- 20 *Atlas Roofing Co. v. Occupational Safety and Health Review Commission*, 430 U.S. 442 (1977).
- 21 *Jarkesy*, 603 U.S. at ___ (slip op., at 24).
- 22 *Jarkesy*, 603 U.S. at ___ (Gorsuch, J., concurring) (slip op., at 11-12).
- 23 *Jarkesy*, 603 U.S. at ___ (Sotomayor, J., dissenting) (slip op., at 2).
- 24 *Jarkesy*, 603 U.S. at ___ (opinion of the Court) (slip op., at 9).
- 25 *Jarkesy*, 603 U.S. at ___ (Sotomayor, J., dissenting) (slip op., at 34).

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