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Legal Sidebar

SEC v. Jarkesy: Constitutionality of Administrative Enforcement Actions

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Congress frequently delegates to agencies the power to take enforcement actions against parties who do not comply with applicable statutes or regulations that the agencies administer. For decades, Congress has enacted statutes that authorize regulatory agencies to impose civil penalties for certain violations. In many of those instances, the relevant statute requires the agency to pursue such penalties through a legal action filed in federal court. Congress has also authorized some agencies to bring enforcement actions before the agencies' own in-house adjudicatory systems. The circumstances under which Congress may authorize agencies to bring in-house enforcement actions was the subject of *Securities and Exchange Commission (SEC) v. Jarkesy*. In June 2024, the Supreme Court ruled 6-3 in *Jarkesy* that the Seventh Amendment's right to a jury trial applies to certain enforcement actions brought by an agency and, therefore, in-house administrative adjudication of such actions is unconstitutional. This Sidebar discusses *Jarkesy* and its implications for Congress and federal agencies.

Background on *SEC v. Jarkesy*

Congress, through various statutes, has tasked the SEC with enforcing statutes and regulatory programs that combat securities fraud and promote market transparency. The SEC may enforce federal securities laws in two ways: (1) by bringing an action for civil penalties in federal court and (2) by pursuing civil penalties before the SEC's own in-house tribunal. Though the agency had the authority to bring some enforcement actions in-house prior to 2010, Congress expanded the SEC's authority to bring in-house actions when it enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The House report accompanying the legislation stated that Dodd-Frank "ma[de] the SEC's authority in administrative penalty proceedings coextensive with its authority to seek penalties in Federal court." Thus, under Dodd-Frank, the SEC could elect to use in-house proceedings for any enforcement action that it could otherwise bring in federal court.

As the Supreme Court noted in *Jarkesy*, the SEC's choice of venue affected the procedural protections available to the parties. If the SEC brought an enforcement action to federal court, a jury could make factual determinations in the case, an Article III judge would preside over the proceedings, and the Federal Rules of Evidence would apply. If the SEC brought the action in an administrative proceeding, a jury would not be available and the facts would be determined by the SEC or an administrative law judge

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(ALJ) designee; the Commission or the ALJ would preside over the hearing; more lenient evidentiary rules would apply; and the SEC's Rules of Practice would govern the proceeding.

Shortly after the passage of Dodd-Frank, the SEC initiated an enforcement proceeding against George Jarkesy Jr. and Patriot 28, LLC for alleged securities fraud. The SEC elected to bring the enforcement action through an in-house proceeding before an ALJ and, at the conclusion of the proceeding, issued an order imposing, among other things, civil monetary penalties. Jarkesy appealed the decision to the U.S. Court of Appeals for the Fifth Circuit (Fifth Circuit), where a divided panel vacated the SEC's order and held that the enforcement scheme that Congress enacted violated the Constitution in three separate ways: (1) the in-house proceedings violated Jarkesy's Seventh Amendment right to a jury trial, (2) the law's lack of guidance establishing when the SEC should elect to pursue an action in court or in an administrative proceeding violated the nondelegation doctrine, and (3) the removal protections afforded to SEC ALJs unconstitutionally infringed on the President's authority to remove officers of the United States. The Supreme Court granted certiorari.

The Supreme Court's Decision

In a 6-3 decision, the Supreme Court affirmed the Fifth Circuit's decision vacating the SEC's order imposing civil penalties against Jarkesy for committing securities fraud because it determined that the Seventh Amendment right to a jury trial applied to the enforcement action. The Court conducted two separate analyses to determine whether the enforcement action fell under the purview of the Seventh Amendment. First, the Court decided the "threshold issue [of] whether this [enforcement] action implicates the Seventh Amendment." After determining that it did, the Court next considered "whether the 'public rights' exception to Article III jurisdiction" applied. These steps are further detailed below. Having vacated the decision on Seventh Amendment grounds, the Court declined to address the Fifth Circuit's decisions on the nondelegation doctrine and removal protections for ALJs.

Civil Penalties Implicate the Seventh Amendment

The Seventh Amendment provides that "[i]n Suits at common law . . . the right of trial by jury shall be preserved." The Seventh Amendment is therefore implicated if the action in question is a "suit[] at common law." Reflecting on prior precedent, the Supreme Court stated that a suit at common law is any suit that is not in admiralty (i.e., maritime) or equity jurisdiction. The distinction between a suit at common law and a suit in equity dates back to the early English legal system, which had distinct courts for actions in law (generally speaking, actions seeking monetary damages for enforcing a legal right established in statute or in common law) and in equity (generally speaking, actions seeking relief other than monetary damages, such as an injunction or specific performance, when legal remedies do not provide adequate relief). Juries were not available in the courts of equity, and the Seventh Amendment reflects that distinction by its explicit application to "suits at common law." Therefore, a suit implicates the Seventh Amendment, the Court stated, if it is "legal in nature," as opposed to equitable.

To determine whether a suit is "legal in nature," the Court had to "consider both the cause of action and the remedy it provides." Pursuant to precedent, the Court stated the type of remedy is the "more important" factor when evaluating the nature of the suit. The Court provided that, although monetary relief is a remedy available in both legal and equitable suits, the nature of the monetary relief will reflect the type of suit at issue. Monetary relief designed to restore the status quo between the parties, such as disgorgement or restitution, is an equitable form of relief, while monetary relief designed to punish or deter wrongdoing, such as a civil monetary penalty, is legal in nature. In Jarkesy's case, the Court held that the remedy at issue—civil monetary penalties—was "all but dispositive" on whether the suit was "legal in nature." The Court reviewed the statutory criteria that the SEC must evaluate when determining whether to seek monetary penalties and found that the criteria concerned "culpability, deterrence, and recidivism." Further, the statute does not require the SEC to reimburse victims of securities fraud with the proceeds of the penalties. These aspects of the law reflected that the purpose of the penalties was to punish the wrongdoer rather than compensate a victim and, therefore, the Court held that this "effectively decides that this suit implicates the Seventh Amendment right."

Although the Court indicated that its evaluation of the remedy was enough to answer the question, it examined the cause of action and determined that this bolstered its conclusion that the SEC's enforcement action implicated the Seventh Amendment right to a jury trial. The Court emphasized the "close relationship" between the statutorily created securities fraud claims pursued by the SEC and common law fraud. Although securities fraud and common law fraud are not identical, the Court found that "Congress's decision to draw upon common law fraud created an enduring link between federal securities fraud and its common law 'ancestor'" and held that the "close relationship between federal securities fraud and common law fraud confirms that this action is 'legal in nature'" and implicates the Seventh Amendment.

The Public Rights Exception Does Not Apply

After determining that the securities fraud claim implicates the Seventh Amendment, the Supreme Court determined that the "public rights" exception, which permits certain matters to be adjudicated outside of Article III courts, did not apply in this circumstance. The Court's test for distinguishing between public and private rights is addressed below. Actions that relate to private rights must be heard in a federal court, and Congress cannot remove those actions to a non-Article III tribunal. Conversely, the Court has recognized that Congress may assign adjudication of actions implicating public rights outside of Article III. Because the Seventh Amendment only guarantees a jury trial if the action is heard in an Article III court, there would be no violation of Mr. Jarkesy's jury right if Congress properly assigned securities fraud claims to be adjudicated before the SEC.

The Court stated that a suit concerns private rights if it "is in the nature of an action at common law," and if private, the suit "may not be removed from Article III courts." Although the Court noted that the Court's jurisprudence on the public rights exception is not particularly clear, it held that if the action is "akin to [a] 'suit[] at common law,'" then it is a private right, and the public rights exception cannot apply. The fact that the action is created by statute or that the government is a party to the action does not factor into the analysis. The Court emphasized that the "substance of the suit" is the deciding factor in its analysis of the public rights exception. The Court reiterated that the SEC's civil penalty remedy is legal in nature and that the claims for securities fraud "target the same basic conduct as common law fraud, employ the same terms of art, and operate pursuant to similar legal principles." Therefore, the Court concluded that the action constituted a private right to which the public rights exception does not apply.

Having determined that the action implicates the Seventh Amendment, and that SEC securities fraud claims are private actions that must be brought in an Article III forum, the Court held that the SEC's in-house enforcement system to impose civil penalties for securities fraud violated Mr. Jarkesy's Seventh Amendment right to a jury trial, and it vacated the SEC's order.

The Concurrence and Dissent

Justice Gorsuch, joined by Justice Thomas, wrote a concurring opinion, while Justice Sotomayor, joined by Justices Kagan and Jackson, dissented. Justice Gorsuch wrote separately to emphasize how the Seventh Amendment, Article III adjudication, and the Fifth Amendment's Due Process Clause work together to protect individual liberties. Highlighting the protections exclusively available in an Article III court, Justice Gorsuch stated that "outside of those limited areas [of public rights], we have no license to deprive the American people of their constitutional right to an independent judge, to a jury of their peers, or to the procedural protections at trial that due process normally demands."

In her dissent, Justice Sotomayor argued that the majority opinion departed from precedent related to the public rights exception and expressed concerns for the practical implications of the Court's decision on the administrative state. Relying heavily on *Atlas Roofing Co. v. Occupational Safety & Health Review Commission*, which the majority distinguished from Jarkesy's case, Justice Sotomayor argued that if the government brings an enforcement action in its sovereign capacity pursuant to a statutory cause of action, then the public rights exception allows Congress to enable that action to be heard outside of Article III. In raising concerns for the practical effect of the majority opinion, Justice Sotomayor cautioned that "more than 200 statutes authorizing dozens of agencies to impose civil penalties for violations of statutory obligations" may be called into question.

Implications of the Decision

The immediate impact of the Court's decision in *Jarkesy* is to prevent the SEC from seeking civil monetary penalties for securities fraud before its own in-house tribunals. Commenters have noted that the SEC has avoided bringing in-house actions while awaiting the resolution of these legal questions in the court system. Further, prior to the enactment of Dodd-Frank, the SEC lacked the authority to pursue these actions in house. Therefore, *Jarkesy* does not appear to have a significant impact on recent SEC practice related to securities fraud, and the post-*Jarkesy* enforcement scheme at the SEC will likely resemble the agency's practices prior to 2010. Nonetheless, the decision could have an impact on SEC's decisions of whether to bring enforcement actions, as litigating these matters in an Article III court are more expensive than adjudicating them in house. Some have noted that the SEC may be more judicious when bringing enforcement actions due to the increased cost associated with litigation in federal court.

Beyond the sphere of SEC enforcement actions, the Court's decision could have an impact across the administrative state. As the Court's decision is not framed in language cabining it to SEC enforcement actions, the decision could impact other agencies' authority to pursue civil monetary penalties through administrative adjudication. Congress has established numerous enforcement structures with the understanding that agencies could pursue civil penalties for violations before their own in-house adjudicators. As Justice Sotomayor noted in dissent, "the constitutionality of hundreds of statutes may now be in peril, and dozens of agencies could be stripped of their power to enforce laws enacted by Congress." Whether these other agency enforcement procedures are held as constitutional will likely depend on whether the actions fall within the public rights exception. If they do, continued adjudication within an agency may be permitted.

It may be difficult to ascertain precisely which actions would fall under the public rights exception in the wake of the Court's *Jarkesy* decision. The Court itself noted that its prior opinions have "not 'definitively explained' the distinction between public and private rights" and it stated that its *Jarkesy* decision did not do so either. Nonetheless, the Court noted that specific subject matters, such as revenue collection, immigration, foreign commerce, federal benefit programs, and relations with Indian Tribes are within the ambit of the public rights exception. Further, the Court declined to overrule *Atlas Roofing*, which held that the imposition of civil monetary penalties related to workplace safety violations was subject to the public rights exception. The Court stated that the workplace safety statutory scheme, unlike the SEC securities fraud action, was "unknown to the common law" and, therefore, could appropriately be assigned to a non-Article III tribunal.

It seems, going forward, that lower courts will have to analyze the type of claim brought against an individual to determine whether the action is sufficiently similar to an action that would have been available at common law. Further development through judicial application may be necessary to understand how closely an action must resemble a common-law claim to foreclose administrative adjudication of the matter. Although actions that draw upon elements of common law fraud may represent clearer cases, questions may linger about other claims. One possible test may be for courts to decide whether such a claim is “akin to [a] ‘suit[] at common law’” in a manner similar to the SEC securities fraud actions or more like OSHA’s workplace safety actions that are “unknown to the common law.”

Assuming that *Jarkesy* will limit agencies’ ability to conduct in-house adjudications, the resulting effect that this has on a particular agency will likely depend on the statutory enforcement authority that agency possesses. Although many agencies, like the SEC, have authority to pursue civil penalties in either federal court or through in-house adjudication, some agencies only have the authority to adjudicate civil penalties in house. For example, Justice Sotomayor, in her dissent, stated that “the Occupational Safety and Health Review Commission, the Federal Energy Regulatory Commission, the Federal Mine Safety and Health Review Commission, [and] the Department of Agriculture,” among other agencies, “can pursue civil penalties only in agency enforcement proceedings.” If a court rules that those actions implicate the Seventh Amendment and fall outside the scope of the public rights exception, those agencies may be unable to enforce violations of the law at all without further congressional authorization. Without a direct enforcement mechanism, an agency’s ability to compel compliance with a statutory program could be significantly curtailed. In some cases, there may be other enforcement mechanisms through which the federal government can deter activities that an agency is unable to directly sanction post-*Jarkesy*. For example, federal criminal prohibitions addressing fraud and the making of false statements may potentially cover some activities that agencies formerly addressed through the in-house adjudication of civil penalties. Depending upon the specific conduct at issue, the availability and practicality of alternative enforcement mechanisms to those found in agency-specific statutes may vary considerably.

Similarly, beyond actions brought by agencies against noncompliant actors, some statutes provide for civil actions before administrative tribunals by private individuals against other private parties. If these actions “implicate the Seventh Amendment” and do not fall under the public rights exception, the constitutional validity of these statutes may come into question. In a potential precursor to future lawsuits, in August 2024 Perdue Farms and Comcast filed separate suits against the Department of Labor (DOL) challenging the constitutionality of in-house proceedings related to whistleblower protection provisions in the Food Safety Modernization Act and the Sarbanes-Oxley Act, respectively. The underlying disputes before the DOL administrative tribunals involve employees claiming unlawful retaliation for whistleblowing against their corporate employers. Citing *Jarkesy*, the complainants allege that requiring the corporations to adjudicate the whistleblower protection claims before the DOL violates their Seventh Amendment right to a jury trial. Other similar statutory provisions may be challenged in the future.

Considerations for Congress

As discussed, the Supreme Court’s opinion in *Jarkesy* could have implications for enforcement actions by regulatory agencies. Agencies that only have the authority to bring enforcement actions before administrative tribunals may lose their ability to enforce the law through civil penalties, if those actions are determined to violate the Seventh Amendment in future litigation. In response, Congress may consider amending the organic acts of these agencies to allow them to bring enforcement actions in federal court to ensure that they are still able to pursue potential violators. Congress could also direct the Department of Justice to take action on the case upon referral or, if Congress wants individual agencies to take the lead in enforcing violations, provide those agencies with independent litigating authority to bring actions in federal court without involving DOJ attorneys.

Congress could also consider alleviating the constitutional problems associated with the administrative adjudication of civil penalties by providing an option for individuals subject to an enforcement action to remove the proceeding to federal court. Arguably, this could cure the constitutional issue because proceedings would only occur outside of an Article III court if the litigants agree to the administrative forum. Litigants desiring a jury trial or other Article III procedural protections could remove the action to federal court, while other litigants desiring the less expensive and potentially expedited administrative proceedings could agree to have their cases heard before the agency. In previous Congresses, Members introduced bills that would have allowed respondents to SEC enforcement actions to remove the proceedings to federal court.

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