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Supreme Court Radically Shifts Landscape for Administrative Enforcement

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In a landmark ruling on June 27, the Supreme Court dramatically curtailed administrative enforcement powers that federal agencies have wielded for over a century. Until now, Congress enjoyed broad discretion to task agencies with policing rules governing vast areas of society by imposing fines in administrative settings. Those days appear to be over.

The decision sets the stage for extensive litigation regarding when the government can collect penalties without jury trials, and hamstrings agency efforts to enforce rules and standards that today can only be enforced administratively.

The ruling in *SEC v. Jarkesy*, No. 22-859, 2024 WL 3187811 (June 27, 2024)—a 6-3 split along ideological lines—may be the final nail in the coffin for the Securities and Exchange Commission's efforts to seek penalties for key securities law violations before tribunals staffed with in-house administrative law judges (ALJs).

The court held that ALJs cannot hear securities fraud cases seeking civil penalties because defendants are entitled to a jury trial under the Seventh Amendment of the U.S. Constitution. The majority's reasoning strongly suggests that other SEC claims resembling traditional common law actions similarly require defendants to get their day in court.

To the extent the SEC pursues contested administrative penalty cases—unlikely except

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in rare situations—defendants will cast many modern regulatory violations, such as falsification of books and records, audit deficiencies, and failures to disclose information in public filings, as little more than dressed-up common law misrepresentation claims that a jury should address.

The court also left open two additional (and existential) grounds on which the U.S. Court of Appeals for the Fifth Circuit demed SEC administrative proceedings unconstitutional, leaving any such proceedings by the SEC or other federal agencies vulnerable to challenges.

The decision is welcome news to critics of the SEC's administrative program, who, in the words of Justice Neil Gorsuch's concurring opinion, have long felt that the "odds were stacked" against defendants when the SEC had home-court advantage. *Id.* at *18.

But the decision sweeps much more broadly than the SEC. The dissent called it a "massive sea change" that takes a "wrecking ball" to centuries of "settled law and stable government practice." *Id.* at *37. Chief Justice John Roberts' majority opinion sharply narrowed precedent that gave agencies considerable flexibility to impose penalties administratively. Instead, the majority acknowledged only a narrow exception to the Seventh Amendment, tacitly inviting lower courts to find that juries are required for many claims that agencies have long pursued in-house.

The decision will profoundly impact dozens of federal agencies that rely on administrative enforcement, including financial markets regulators overseen by the SEC like the Financial Industry Regulatory Authority (FINRA) and the Public Company Accounting Oversight Board (PCAOB), and even state agencies constrained by Seventh Amendment equivalents in their state constitutions.

The Supreme Court's Decision

Before the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC could only impose civil penalties administratively on SEC-registered entities like broker-dealers, investment advisers, and associated individuals.

For everyone else, the SEC had to sue in federal court. Dodd-Frank expanded the SEC's power, allowing it to impose penalties against all violators administratively. The SEC used this authority frequently, including in a 2013 fraud action against hedge fund manager George Jarkesy, Jr and his investment adviser firm, resulting in a $300,000 civil penalty, an industry bar, disgorgement, and a cease-and-desist order.

On appeal, the Fifth Circuit vacated the order on three constitutional grounds: (1) violation of the Seventh Amendment right to a jury trial; (2) improper congressional delegation of legislative power by allowing the SEC to route cases to ALJs, without an "intelligible principle" governing the choice between ALJs and federal court; and (3) ALJ civil service tenure protections violated separation of powers and improperly limited presidential control over ALJs. *Jarkesy v. SEC*, 34 F.4th 446, *reh'g denied*, 51 F.4th 644 (5th Cir. 2022).

The Supreme Court affirmed only on the Seventh Amendment issue, leaving the non-delegation and removal issues undecided. The Court found that SEC fraud cases seeking civil penalties require a jury because they are "legal in nature" (not equity or admiralty), resemble common law actions seeking remedies traditionally available from courts of law, and aim to "punish the defendant rather than to restore the victim." *Jarkesy*, 2024 WL 3187811, at *8.

While noting the "close relationship" between securities antifraud provisions and common law fraud, *id.* at *9, the court's analysis implies that all federal enforcement actions seeking civil penalties are legal, not equitable, and presumptively trigger a jury trial right.

The court then addressed whether the "public rights" exception—which allows Congress to assign certain claims to agencies for decision without a jury (including those seeking civil penalties)—should apply. While acknowledging it has never "definitively explained the distinction between public and private rights," *id.* at *12, the majority noted that cases recognizing the exception pertained to issues historically resolved "exclusively" by executive or legislative branches—revenue collection, customs, immigration, "relations with Indian tribes, the

administration of public lands, and the granting of public benefits such as payments to veterans, pensions, and patent rights." *Id.* at *10, *12.

The majority emphasized that it is immaterial that the government is bringing a claim, or that a claim is part of a statutory scheme administered by an agency. All that matters for the public rights exception "is the substance of the suit, not where it is brought, who brings it, or how it is labeled." *Id.* at *14. Accordingly, securities fraud claims—rooted in common law and providing a legal remedy—do not qualify.

In dissent, Justice Sonia Sotomayor argued that the majority's narrow construction of the public rights exception sharply breaks with precedent, particularly *Atlas Roofing Co., Inc. v. Occupational Safety & Health Review Commission*, 430 U.S. 442 (1977), which described the exception as broadly covering any "cases in which the government sues in its sovereign capacity to enforce" federal law. *Id.* at *45 (Sotomayor, J., dissenting).

The majority suggested *Atlas Roofing* may no longer be good law (noting that Justice White, who wrote it, complained that a subsequent Supreme Court decision effectively overruled it, *id.* at *15 n.3) and concluded that at most it applied to novel regulatory regimes with no common law roots.

Both the majority and dissent seemed to agree on one crucial point: Justice Sotomayor warned that *Jarkesy* could affect "hundreds of statutes" across "dozens of agencies," *id.* at *45, an assertion the majority did not dispute.

Key Implications

Jarkesy heralds a new era of legal challenges to agency enforcement—with major consequences for both agencies and those facing enforcement actions:

First, the decision forces agencies to revamp strategies and priorities, contemplate legislative fixes for gaps in enforcement powers, and brace for a wave of litigation testing the limits of their powers. That wave is coming fast because *Axon Enterprises, Inc. v. FTC* now allows respondents to contest the constitutionality of administrative proceedings in court before the agency process concludes. 598 U.S. 175 (2023).

The decision may also shift settlement dynamics, especially when agencies threaten to charge violations they cannot assert in court or where they are perceived to be reluctant to go to court.

Second, although *Jarkesy* explicitly requires jury trials only for claims with common law roots, the majority's suggestion that *Atlas Roofing* may no longer be good law invites lower courts to relegate the public rights exception to its historical origins of customs, immigration, tax, and public benefits cases. If lower courts do so, every federal agency claim seeking penalties may presumptively be subject to a jury trial right.

Moreover, the Court's narrow construction of the "public rights" doctrine is not necessarily limited to those seeking penalties that implicate the Seventh Amendment. As the dissent emphasized, this doctrine provides the constitutional foundation for removing the power of adjudication from Article III courts and assigning it to administrative agencies. *Jarkesy*, 2024 WL 3187811, at *32.

Thus, the Court's narrow construction of the doctrine opens the door to arguments that claims for other forms of relief, including equitable relief and compensatory damages, may be required to be brought in federal court under Article III of the Constitution. Some agencies, including the Occupational Safety and Health Review Commission and the Federal Energy Regulatory Commission, may be unable to assess penalties altogether until Congress authorizes them to seek penalties in court. *Id.* at *45.

Even if lower courts construe *Jarkesy* as requiring jury trials only for common law-derived claims, determining which claims fit the "common-law-private rights" box will be challenging, likely leaving dozens of agencies mired in litigation for years to come.

Third, the decision provides none of the clarity the SEC hoped for. Aside from a few "test" cases to establish a basis for administrative adjudication of some matters, the SEC will likely

avoid contested administrative proceedings (as it has been doing for several years). In any contested proceeding the SEC files, defendants could promptly ask a court to rule that the case must be brought before a jury, or that the entire ALJ process is unconstitutional based on the Fifth Circuit's unaddressed non-delegation and removal holdings (which apply even to claims that do not seek penalties).

Fourth, the SEC's inability to use in-house tribunals is especially consequential for claims it can *only* bring administratively. Some of its most potent enforcement tools, like holding secondary actors liable for negligently "causing" violations by others or failing to reasonably supervise persons associated with registered entities, can only be asserted in administrative proceedings. 15 U.S.C. §§78o(b)(4)(E), (b)(6)(A).

Absent legislative action, these expansive forms of secondary liability will become a dead letter if the SEC cannot proceed administratively. The SEC can still bring aiding and abetting cases in court, but these require proof of scienter, rather than mere negligence—a much higher bar.

Fifth, other financial markets regulators like FINRA and PCAOB could lose their authority to assess financial penalties. They regularly penalize market participants in administrative proceedings for violations of common-law derived rules that now seemingly require a jury trial: FINRA imposes penalties under rules that mirror the antifraud provisions at issue in *Jarkesy*, and PCAOB cases are often analogous to common law theories of fraud or professional malpractice. The rules these entities enforce are approved by the SEC, and their decisions are appealable to the SEC, but both agencies lack authority to file court actions.

These agencies likely will argue that they are not subject to the Seventh Amendment, but precedent suggests otherwise. The Supreme Court has described the PCAOB as subject to the same constitutional requirements applicable to the SEC. *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 486 (2010). And the D.C. Circuit has suggested FINRA likely is as well—with one judge describing FINRA's hearing officers as "carbon copies" of the SEC's ALJs. *Alpine Sec. Corp. v. Fin. Indus. Regul. Auth.*, No. 23-5129, 2023 WL 4703307, at *2 (D.C. Cir. July 5, 2023) (Walker, J., concurring).

These agencies likely will retain some enforcement powers, particularly suspension or debarment authority, but may be unable to impose monetary penalties for fraud and potentially other misconduct—forcing the SEC to pick up the slack.

Finally, while state agencies are not subject to the Seventh Amendment, nearly all states have constitutional jury trial protections—often interpreted as coextensive with the Seventh Amendment. If state courts decide to adopt *Jarkesy*, state agencies might need jury trials to impose fines. That is a big problem if the agency lacks power to seek penalties in court, or if that is a choice the agency is uncomfortable making.

Ironically, eighteen state attorneys general, led by West Virginia, filed an amicus brief supporting Jarkesy's jury trial argument. But if followed by state courts, *Jarkesy* could limit the enforcement powers of agencies in some of those states. For example, West Virginia's Securities Commission can seek penalties administratively, but not in court. W. Va. Code Ann. § 32-4-407a.

The same is true for some state agencies with active enforcement programs that did not join the amicus brief, such as the Massachusetts Securities Division. Mass. Gen. Laws ch. 110A § 407A. While it is uncertain how state courts will interpret both *Jarkesy* and their own jury trial requirements, the decision is likely to spark significant litigation in states where litigants hope to limit administrative enforcement powers.

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