

SEC v. Jarkesy: A Divided Supreme Court Holds That the SEC Cannot Seek Civil Penalties through an Administrative Proceeding

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June 28, 2024

On June 27, 2024, the United States Supreme Court (the “Court”) affirmed the Fifth Circuit’s ruling in *SEC v. Jarkesy* and held that a defendant facing civil penalties in a securities fraud claim brought by the Securities and Exchange Commission (the “SEC”) has a right to a jury trial in a federal court.¹ Specifically, the Court held that the SEC’s attempt to compel respondents to defend themselves before the agency, namely in an administrative proceeding before an Administrative Law Judge (“ALJ”) employed by the SEC, violates respondents’ Seventh Amendment right to a jury trial in cases where the SEC pursues civil penalties. Accordingly, this decision will likely limit the number of future SEC actions adjudicated by an ALJ in an administrative forum due to the restriction on the available remedies.

I. Background

The Court began its opinion by discussing how, in 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which permitted the SEC to seek civil penalties in federal court or through its own in-house proceedings.² After the passage of the Dodd-Frank Act, the SEC initiated an administrative proceeding against George Jarkesy and his associated investment advisor, Patriot 28 (collectively, “Respondents”), alleging that Respondents violated certain provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940 (collectively, the “Antifraud Provisions”). Specifically, the SEC alleged that Respondents misled investors by: (1) misrepresenting the investment strategies employed, (2) lying about the identity of the funds’ auditor and prime broker, and (3) inflating the funds’ claimed value to collect larger management fees.³ Following the SEC’s final order, Respondents filed a petition for review before the Fifth Circuit, which granted the petition and vacated the final order. The Fifth Circuit held that the SEC’s decision to adjudicate the matter through an administrative proceeding, where there is no right to a trial by a jury, violated Respondents’ Seventh Amendment right to a jury trial.

II. The Antifraud Provisions Implicate Respondents’ Seventh Amendment Rights

The Court affirmed the Fifth Circuit’s decision and held that the SEC’s administrative proceeding violated the Respondents’ Seventh Amendment rights.⁴ The Court reasoned that the Antifraud Provisions closely resemble common law fraud claims, which are legal in nature and thus, must be heard by a jury. The Court explained that the right to a trial by a jury is of utmost importance and any attempt to curtail this right must be carefully scrutinized.⁵ It further opined that the Seventh Amendment extends to the Antifraud Provisions because the civil penalties are “designed to punish and deter” conduct

¹ *SEC v. Jarkesy*, No. 22-859 (June 27, 2024). In a 6-3 decision, Chief Justice Roberts delivered the opinion of the Court, in which Justices Alito, Gorsuch, Kavanaugh, and Barrett joined. Justice Gorsuch filed a concurring opinion, in which Justice Thomas joined. Justice Sotomayor filed a dissenting opinion, in which Justices Kagan and Jackson joined.

² *Id.* at 4.

³ *Id.* at 4-5. The SEC’s final order: (1) held that Respondents committed securities fraud, (2) levied a civil penalty of \$300,000, (3) directed Respondents to cease and desist from committing or causing future securities laws violations, (4) ordered Respondents to disgorge of earnings, and (5) prohibited Jarkesy from participating in the securities industry and selling penny stocks.

⁴ *Id.* at 6-7.

⁵ *Id.* at 7.

rather than provide an equitable remedy.⁶ Thus, since the Antifraud Provisions are “legal in nature” and the civil penalties are a form of monetary relief designed to deter misconduct, the claim must be presented to a jury.⁷

III. The “Public Rights” Exception to Federal Court Jurisdiction Does Not Apply

The SEC (and the dissent) argued that a “public right” exception permitted the SEC to bring its claims in an administrative proceeding. The Court rejected this argument, finding that while Congress may, in some instances, assign matters of “public right” to an agency without violating the Seventh Amendment, a violation of the Antifraud Provisions involves a matter of *private* right and “‘Congress may not withdraw’ it ‘from judicial cognizance.’”⁸

The Court distinguished *Atlas Roofing Co. v. Occupational Safety and Health Review Commission*, 430 U.S. 442 (1997), a case relied upon by the SEC and the dissenting justices, on the grounds that *Atlas Roofing* did not address lawsuits involving fraud or traditional legal claims, unlike the SEC’s action against the Respondents.⁹ The Court also rejected the argument that “effects like increasing efficiency and reducing public costs” are enough to trigger the “public rights” exception.¹⁰ Unlike the novel claims in *Atlas Roofing*—which had never been brought before a federal court—the Court reasoned that “law courts have dealt with fraud actions” since the founding of our nation, and that Congress had authorized the SEC to bring its claims in federal court from the very beginning as well.¹¹ Thus, the Court rejected the implication that the federal court system would lack the capacity to review the SEC’s fraud claims.¹² Ultimately, the Court concluded that the “public rights” exception did not apply.

IV. Key Takeaways

The holding in *Jarkesy* has the potential to significantly limit administrative agencies’ use of in-house courts to adjudicate traditional legal claims and recover civil penalties. With respect to SEC enforcement actions, it is now clear that “[a] defendant facing a fraud suit has the right to be tried by a jury of his peers before a neutral adjudicator.”¹³ As a result, the SEC’s use of administrative proceedings to prosecute federal securities law violations will undoubtedly be reduced because the SEC will now be forced to go through the federal courts to recover civil penalties.

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⁶ *Id.* at 11.

⁷ *Id.* at 12-13 (quoting *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989)).

⁸ *Id.* at 21 (quoting *Stern v. Marshall*, 564 U.S. 462, 484 (2011) (internal citation omitted)).

⁹ *Id.* at 22. In the dissent, Justice Sotomayor opined that the majority’s holding threatens the separation of powers by finding that “Congress cannot assign a certain public-rights matter for initial adjudication to the Executive because it must come only to the Judiciary.” *Id.* at 2 (Sotomayor, J., dissenting).

¹⁰ *Id.* at 26.

¹¹ *Id.* at 27.

¹² *Id.*

¹³ *Id.*