

ESG Daily, ENFORCEMENT—U.S.: Respondents in SEC enforcement matters seeking civil penalties are entitled to jury trials, (Jun 27, 2024)

By [Mark S. Nelson, J.D.](#)

The majority reasoned that securities fraud derives from common law and, thus, seeks to adjudicate private rights; the majority also said a prior opinion was not contrary because that case involved a new statutory right without common law origins.



The U.S. Supreme Court held by a 6-3 majority that respondents in SEC enforcement actions seeking civil penalties for securities fraud are entitled to a federal court jury trial under the Seventh Amendment because under one of two relevant precedential opinions the rights adjudicated are private legal claims, not public ones, because the SEC's claims derive from the common law. The majority also said that one of its prior opinions, which emphasized the distinction between public (i.e., enforcing the sovereign's rights) and private rights in the agency enforcement context, was not contrary because that case involved a Congressional delegation of authority to a federal agency to enforce a new statutory right that lacked common law origins. However, the *Jarkesy* opinion may not end litigation challenging other aspects of the SEC's enforcement powers because the majority limited its opinion to the Seventh Amendment jury question and, thus, did not address the Article II removal question or the even broader nondelegation doctrine question, both of which were briefed but only tangentially addressed at oral argument. Justice Sotomayor wrote a lengthy dissent arguing that the majority undermined separation of powers by engaging in a power grab that limited Congressional power to sculpt remedial regimes at federal agencies. The case was remanded for further proceedings consistent with the Court's opinion ([SEC v. Jarkesy](#), No. 22-859 (U.S. June 27, 2024)).

The case arose from the SEC's use of an in-house action authorized by the Dodd-Frank Act to charge George Jarkesy and his hedge fund with misleading investors about the fund's investment strategies and the identity of the fund's auditor and prime broker, while also alleging that Jarkesy inflated the fund's value. The SEC imposed a \$300,000 civil penalty, issued a cease-and-desist order, ordered disgorgement, and imposed industry and penny stock bars against Jarkesy. Jarkesy filed a petition for review in the Fifth Circuit and a split panel concluded that the SEC's action against Jarkesy should have been brought in federal court per the Seventh Amendment's jury trial guarantee in civil cases, and that the SEC's action also violated the nondelegation doctrine and that the administrative law judge in the matter enjoyed too many layers of tenure protection in violation of Article II of the Constitution. The SEC then appealed that decision to the Supreme Court.

Securities fraud requires jury trial. The majority, led by Chief Justice Roberts, began by asking if the Seventh Amendment was implicated in *Jarkesy*? The majority answered in the affirmative. The majority then asked if the public rights exception developed in multiple precedential cases applied? The majority said "No."

Here, the majority explained how to tell the difference between when the rights sought to be adjudicated by an agency are public or private. Under the public rights exception Congress can sometimes assign an agency authority to adjudicate certain claims without a jury consistent with the Seventh Amendment. The Court's explanation focused on two prior opinions:

- In *Tull v. U.S.*, 481 U. S. 412 (U.S. 1987), the government sued a real estate developer in federal court for violations of the Clean Water Act. The government's suit asked for civil money penalties but the district court denied the defendant's request for a jury trial. The Supreme Court explained that the requirement of a jury trial depends on an analysis of the cause of action and the remedy, although the remedy is the key factor. The

Supreme Court held that a jury trial was required in *Tull* regarding liability, but not regarding the amount of any penalty. Two justices concurred in part and dissented in part, arguing that a jury was required for both the liability and penalty phases of the case.

- In *Granfinanciera, S. A. v. Nordberg*, 492 U. S. 33 (U.S. 1989), the question was whether avoidance by a bankruptcy trustee (i.e., fraudulent conveyance cases) under the Bankruptcy Code required a jury trial. The Bankruptcy Code allowed such cases to be heard by non-Article III bankruptcy judges without juries. The Supreme Court held that fraudulent conveyance claims were rooted in common law and were “not inseparable” from the bankruptcy process. Thus, the public rights exception was inapt and a jury trial was required.

In *Jarkesy*, for one, the Court said the Seventh Amendment applied to civil cases involving “suits at common law.” The Fifth Circuit had equated the SEC’s charges against Jarkesy with traditional actions in debt that historically required a jury trial. The Supreme Court explained that the case turned primarily on the remedy sought by the SEC, which the majority said was legal rather than equitable in nature because the Securities Act, Exchange Act, and Investment Advisers Act antifraud provisions at issue were infused with statutory purposes centered on “culpability, deterrence, and recidivism.” In other words, any purpose focused on a civil monetary penalty that seeks to punish or deter conduct tends to be a legal claim. The majority also noted that the tiered, progressively more severe, penalty structure of the applicable statutes also tended to show the remedy was legal as did the fact that the SEC need not return money it collected to fraud victims (by way of background, the Court had in a prior case explored the question of the return of money to victims in the disgorgement context as being determinative of whether the penalty was punitive).

“In sum, the civil penalties in this case are designed to punish and deter, not to compensate. They are therefore ‘a type of remedy at common law that could only be enforced in courts of law,’” wrote Justice Roberts. “That conclusion effectively decides that this suit implicates the Seventh Amendment right, and that a defendant would be entitled to a jury on these claims” (citations omitted).

Moreover, the majority considered the fact that federal securities fraud claims are in some respects both broader and narrower than similar common law claims but said that tension did not alter the outcome in *Jarkesy*. “Nevertheless, the close relationship between federal securities fraud and common law fraud confirms that this action is ‘legal in nature,’” added Justice Roberts.

With respect to the Court’s opinion in *Granfinanciera*, the majority rejected the SEC’s arguments that Congress had created a new statutory scheme for the SEC and that it mattered that the government was the party prosecuting Jarkesy. The Court reiterated that if a right resembles a traditional legal claim, then the statutory origins of that claim are not dispositive. The court added that the government as the party pursuing the case misses the majority’s point that the “substance” of the claim is key and does not depend just on where a case is brought, or by whom, or how it is labeled. A later opinion from the Court, said the majority, had clarified that the “the Seventh Amendment does apply to novel statutory regimes, so long as the claims are akin to common law claims.”

The majority also said *Atlas Roofing Co. v. Occupational Safety and Health Review Commission*, 430 U. S. 442 (U.S. 1977), a key precedent relied on by the government in *Jarkesy*, simply did not apply and that the Court need not reach the “suggestion” from *Jarkesy* that *Granfinanciera* had at least partially overruled *Atlas Roofing*. In *Atlas Roofing*, the Occupational Safety and Health Review Commission sought to adjudicate violations of regulations adopted under the Occupational Safety and Health Act that had no roots in common law. The majority in *Jarkesy* characterized *Atlas Roofing* as involving occupational safety requirements that read more like a “building code” devoid of terminology indicative of the common law.

In a footnote, the majority suggested, while not expressing a view on numerous academic critiques of *Atlas Roofing*, that the opinion had been treated, at best, as an outlier, and at worst, had been “ignored” by those studying the interplay between Article III of the Constitution and agency adjudications. Returning now to the main text of the majority’s opinion, Justice Roberts, anticipating the dissent’s counterargument, added: “The reasoning of *Atlas Roofing* cannot support any broader rule. The dissent chants ‘*Atlas Roofing*’ like a mantra, but no matter how many times it repeats those words, it cannot give *Atlas Roofing* substance that it lacks.”

The dissent sees a “power grab.” Justice Sotomayor, joined by Justices Kagan and Jackson, wrote that the majority’s opinion could result in “chaos” given that Congress has created 200 statutory enforcement provisions at dozens of agencies that grant those agencies power to hear in-house cases, including the CFPB, and the EPA which, like the SEC, can pursue in-house cases and federal court cases. “Today, for the very first time, this Court holds that Congress violated the Constitution by authorizing a federal agency to adjudicate a statutory right that inheres in the Government in its sovereign capacity, also known as a public right,” wrote Justice Sotomayor.

According to the dissent, the majority put at risk the Court’s adherence to stare decisis (i.e., following previously decided cases) and to the rule of law. Immediately preceding this claim, the dissent said: “It should be obvious by now how this case should have been resolved under a faithful and straightforward application of *Atlas Roofing* and a long line of this Court’s precedents. The constitutional question is indistinguishable. The majority instead wishes away *Atlas Roofing* by burying it at the end of its opinion and minimizing the unbroken line of cases on which *Atlas Roofing* relied.”

For Justice Sotomayor, the majority not only cited inapt precedent, it engaged in a judicial “power grab” by limiting the public rights exception to instances of its own choosing. That, said the dissent, implicates the separation of powers between the legislative, executive, and judicial branches.

Justice Sotomayor concluded by addressing the scope of the majority’s opinion. Said the dissent: “The majority claims that its ruling is limited to ‘civil penalty suits for fraud’ pursuant to a statute that is ‘barely over a decade old,’ an assurance that is in significant tension with other parts of its reasoning. That incredible assertion should fool no one. Today’s decision is a massive sea change. Litigants seeking further dismantling of the ‘administrative state’ have reason to rejoice in their win today, but those of us who cherish the rule of law have nothing to celebrate” (citations omitted).

The concurrence and the philosophy of jury trial rights. Justice Gorsuch, joined by Justice Thomas, concurred to amplify how Article III, the due process clause of the Fifth Amendment, and the Seventh Amendment work together to require jury trials in many instances. Justice Gorsuch also saw the outcome in *Jarkesy* as resetting the SEC’s authority to the SEC’s pre-Dodd-Frank Act powers. “In reaffirming all this today, the Court hardly leaves the SEC without ample powers and recourse,” said Justice Gorsuch. “The agency is free to pursue all of its charges against Mr. Jarkesy. And it is free to pursue them exactly as it had always done until 2010 [i.e. before the Dodd-Frank Act]: In a court, before a judge, and with a jury.”

It is worth noting that the Court’s recent opinion in [Erlinger v. U.S.](#), authored by Justice Gorsuch, perhaps tipped how *Jarkesy* would be decided, at least regarding the need for a jury trial. The two cases are different in many ways, one is civil and the other criminal and one is focused on the Seventh Amendment while the other is focused on the Fifth and Sixth Amendments. Part II A of the *Erlinger* opinion contained a number of broad philosophical pronouncements about when jury trials should be required. That case appeared once in the majority’s opinion in *Jarkesy* and six times in justice Gorsuch’s concurrence in *Jarkesy*.

In *Erlinger*, the question was whether a trial judge, for purposes of increasing a defendant’s potential prison time under the Armed Career Criminal Act (ACCA), can make a determination based upon a preponderance of the evidence about the number of occasions on which the defendant committed violent felonies or certain drug offenses

that qualify under ACCA or whether that determination must be made by a unanimous jury under the beyond-a-reasonable-doubt standard. A six-justice majority in *Erlinger* held that, under the Court's precedents, the occasions determination under ACCA must be made by a jury.

Reaction to decision. The public reaction to the *Jarkesy* opinion has been somewhat muted, but those groups that have issued statements have tended to gravitate to well-known and predictable views of the case.

For example, the New Civil Liberties Alliance, one of several groups to file friend of the court briefs in the case, [welcomed](#) the opinion. "This is a day to rejoice! The Supreme Court's restoration of Americans' constitutional guarantee of a right to be tried by a jury of their peers marks a historic declaration of independence from decades of encroachments by the Administrative State," said Peggy Little, a Senior Litigation Counsel at the NCLA. "The Dodd-Frank Act's attempt to extinguish Americans' jury-trial protections by sweeping securities prosecutions into the SEC's notoriously biased in-house courts—where agencies prevail 90-100 [percent] of the time—has come to a well-deserved end."

Mark Chenoweth, the NCLA's President, opined about the scope of the *Jarkesy* opinion: "What's more, this landmark decision does not just apply to adjudications at the SEC, it also applies to every other federal agency that engages in similar kinds of unconstitutional administrative adjudication."

On the other side of the ledger, a [statement](#) from Better Markets worried about whether the opinion may have a larger impact beyond the SEC. "The decision, which sharply veers away from long-established precedent, upends the SEC's enforcement program and promises a further drain on its already strained resources," said Stephen Hall, Legal Director and Securities Specialist at Better Markets. "It also comes at an especially bad time, given the rise in crypto investment schemes that require vigorous enforcement. And it also casts grave doubt on the ability of other agencies to use administrative law judges as an efficient but fair method of holding lawbreakers accountable."

Looking ahead. The majority opinion left open the possibility of renewed legal challenges to the SEC's enforcement authorities under Article II of the Constitution and under the nondelegation doctrine. The former question would address whether the SEC's administrative law judges enjoy too many layers of tenure protection such that the president cannot adequately oversee their actions. The latter question is a broadside attack on the SEC's enforcement authorities that argues that when Congress delegated substantial powers to the SEC, those lawmakers failed to provide an intelligible principle by which the agency could apply those powers. Both of these questions were briefed in *Jarkesy* but oral argument focused almost exclusively on the Seventh Amendment jury trial question, which was the sole issue addressed in the majority's opinion.

Nevertheless, under the Seventh Amendment approach taken by the majority in *Jarkesy*, other federal agencies whose enforcement powers rely on claims with common law origins (e.g., "civil penalty suits for fraud") still may need to carefully consider their authorities in light of the majority's reasoning. In particular, agencies likely can no longer rely exclusively on the public-private dichotomy set forth in *Atlas Roofing* because, as the majority in *Jarkesy* emphasized, it is the common law origins of a claim that matter and that that approach can extend even to novel statutory schemes if they are grounded in the common law.

The case is [No. 22-859](#).

Judge: Roberts, J.

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