

[Securities Regulation Daily Wrap Up, SUPREME COURT DOCKET—U.S.: SEC challenges holding that ALJ proceedings are unconstitutional, \(Mar. 14, 2023\)](#)

Securities Regulation Daily Wrap Up

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By [Rodney F. Tonkovic, J.D.](#)

The Fifth Circuit held that the SEC's in-house proceedings were unconstitutional, and the SEC has now brought the matter to the attention of the Supreme Court.

The SEC has filed a petition for certiorari challenging a circuit court decision that could upend the Commission's enforcement regime. In May 2022, the Fifth Circuit held that the Commission's administrative proceedings violated the petitioners' Seventh Amendment right to a jury trial and that Congress unconstitutionally delegated to the SEC the power to decide which proceedings should remain in-house and which should be brought in the courts. With the Fifth Circuit having facially invalidated provisions of federal statutes, the SEC urges the Court to review the decision. The holding is not only in conflict with over a century of precedent, the petition contends, but it may also have significant adverse effects for a host of federal agencies that bring proceedings seeking civil penalties ([SEC v. Jarkesy](#), March 8, 2023).

The long journey. The story begins ten years ago: in March 2013, the Commission [accused](#) hedge fund manager George R. Jarkesy with defrauding investors in two hedge funds and steering millions in fees to a broker-dealer. Jarkesy's co-respondents [settled](#), but Jarkesy challenged the proceeding in the district court in D.C., arguing that the settled order included findings that he had violated the securities laws. He sought to stay the administrative proceeding for Due Process violations arising from the SEC's alleged prejudgment of the case.

The district court [concluded](#) that it had no concurrent jurisdiction to consider the challenge, and the [D.C. Circuit](#) agreed that Congress intended for Jarkesy's claims to go through the administrative process before being appealed to an appellate court. The proceedings resumed, and the Commission eventually [affirmed](#) the ALJ's conclusion that Jarkesy and his investment adviser committed securities fraud and ordered penalties and disgorgement totaling almost \$1 million, along with barring Jarkesy from various activities. Jarkesy then challenged the proceedings in federal court.

Fifth Circuit holds unconstitutional. In May 2022, a 2-1 panel of the [Fifth Circuit](#) Court of Appeals vacated and remanded the decision against Jarkesy. The panel [held](#) that the administrative proceedings suffered from three independent constitutional defects, the first two of which each provided a standalone basis for vacating the SEC's decision:

1. The petitioners were deprived of their constitutional right to a jury trial;
2. Congress unconstitutionally delegated legislative power to the SEC by failing to provide an intelligible principle to guide its exercise of that power; and
3. The statutory removal restrictions on SEC ALJs violate Article II by depriving the President of adequate control.

A majority of the Fifth Circuit [denied](#) the SEC a rehearing en banc.

Grant cert and reverse. The petition maintains all three of the circuit court's holdings warrant review and that the Court should grant certiorari and reverse. Each holding is highly consequential, the SEC says, and calls longstanding practices at the SEC—and other agencies—into question.

First, the appellate court erred in holding that Congress violated the Seventh Amendment by authorizing the SEC to bring administrative proceedings seeking civil penalties. Congress has broad authority to assign adjudication of "public rights" to entities other than Article III courts, and there is a long line of Supreme Court precedent holding that administrative proceedings like the SEC's seeking civil penalties qualify as matters involving public rights. The court's reasoning was flawed, the petition says, because Congress may assign a matter involving public rights to an agency even where the Seventh Amendment would require a jury in a federal court. Plus, Congress's decision to allocate some securities enforcement proceedings to courts does not stop it from allocating others to agencies.

The SEC next argues that the panel erred in holding that Congress violated the nondelegation doctrine by giving the SEC the power to bring fraud actions in-house. The Commission's decision to pursue either an administrative or judicial remedy is a core executive function, the petition says, not an exercise of legislative power. The decision whether and where to pursue an enforcement action involves the execution rather than the making of law, and the Court has never suggested otherwise, the SEC says.

Finally, the SEC argues that the court erred in holding that the two layers of removal protection granted to SEC ALJs is unconstitutional. SEC ALJs can only be removed by the SEC Commissioners if the Merits System Protection Board finds good cause, and SEC Commissioners and MSPB members can only be removed by the President for cause. The circuit panel held that the two-layer for-cause protection for PCAOB members that the Supreme Court held unconstitutional in *Free Enterprise Fund v. PCAOB* (U.S. 2010). But, the petition says, unlike the board members in *Free Enterprise Fund*, the SEC ALJs perform adjudicative functions, and the power of the President to remove quasi-judicial officers can be limited; the SEC's removal standard is also less stringent than the PCAOB standard at issue.

Read the Docket. This case, and others before the Court may be referenced in the latest version of the [Supreme Court Docket](#). Issued opinions, granted petitions, pending petitions, and denied petitions are listed separately, along with a summary of the questions presented and the current status of each appeal.

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

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