

## SEC Enforcement Case Summary

### Supreme Court Declares Civil Penalties for Securities Fraud in SEC Administrative Proceedings Unconstitutional

On June 27, 2024, in a long-awaited decision in the *Jarkesy v. Securities and Exchange Commission* case, the Supreme Court ruled that the SEC must bring all securities fraud enforcement in federal court when it seeks civil penalties, rather than in the agency's own administrative tribunals in front of administrative law judges (**ALJs**) because the Seventh Amendment right to a jury trial applies. The *Jarkesy* opinion settles one, but not all, of the questions that have been pending since George Jarkesy first challenged the SEC's authority to penalize him for securities fraud in an administrative action in 2013, alleging he and his firm, Patriot28, violated anti-fraud provisions of the securities acts and after an appeal. The ALJ subsequently issued an order enjoining Jarkesy from further violations, banning him from the industry, and requiring him to disgorge \$685,000 in alleged ill-gotten profits, along with \$300,000 in civil penalties. Jarkesy appealed to the Fifth Circuit, which ultimately found that the SEC's use of ALJs in fraud trials violated the Seventh Amendment and that both ALJ appointments and the tribunals themselves were unconstitutional because they were not within Congress's power to give to the SEC. The Court declined to rule on the other questions when it issued its July 2024 opinion. In deciding *Jarkesy*, the Court easily analyzed statutory securities fraud as sufficiently similar to common law fraud and dispensed with the SEC's arguments, holding that the Seventh Amendment's protections apply to any enforcement brought by the SEC under Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Section 206 of the Investment Advisers Act of 1940, some of the federal securities acts from which the SEC derives its authority to regulate the markets, protect investors, and enforce violations of the acts. This comes at a time when the agency is experiencing budget cuts. It closed at least one office this year (the Salt Lake Regional Office), and concern about how the SEC will continue to have the resources to litigate its cases has been unofficially expressed by certain SEC staff.

Historically, the SEC has been authorized to seek civil monetary penalties via enforcement actions using administrative or judicial court as the forum, with certain limitations. Since 1990, the agency has been authorized to seek civil penalties from registrants, but not non-registrants, for violations of the federal securities laws. Prior to this grant of authority, it could bring insider trading actions seeking civil monetary penalties for insider trading by obtaining a court order. Congress stopped short of giving the SEC full power over registrants and non-registrants in its 1990 legislation, in part to address constitutionality concerns surrounding "quasi-legal" remedies being applied to citizens who did not consent to SEC regulation. To obtain civil penalties against non-registrants, the SEC was required to elect to file its complaint

in federal court and obtain a court-ordered remedy. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 later empowered the SEC to adjudicate and seek civil penalties for securities fraud from both registrants and non-registrants alike, using its own tribunal and ALJs to issue orders for civil penalties alongside others.

In light of *Jarkesy*, the SEC will be forced to return to its pre-Dodd-Frank enforcement framework, both as legally mandated and practically, as enforcement staff dust off any necessary pre-Dodd-Frank enforcement strategy and tactics and bring cases in federal courts where required. Such a pivot with respect to any current, pending, or planned enforcement activity would seem reasonably manageable, since the concept that the remedy dictates the forum selected is not a new one, as noted above. However, the SEC's use of administrative settlement orders, a significant source of its revenue, may suffer indirectly. After the SEC files its complaint against a defendant, the parties often settle the case before it gets to its trial or adjudication. In these settlements, the SEC and the defendant agree to certain facts as true, and the defendant receives the resulting penalties or remedies as outlined in the agreement, which is then typically incorporated into a court order by a federal judge or an ALJ. Defendants are not required to admit guilt in a settlement agreement, but may instead choose to accept the order, but will stipulate they neither admit nor deny wrongdoing. While *Jarkesy* does not directly apply to administrative settlements, the utility of agency-friendly and efficient settlement as an enforcement strategy for the SEC is poised to suffer under *Jarkesy*'s indirect application, starting with any of the cases now required to obtain federal court orders for their civil penalties. All such matters would be required to be filed in federal district courts initially, and the settlement process and resulting orders would be subjected to the federal rules of procedure as well as its circuit court judges, which may be less friendly to the agency than its own tribunal and ALJs. Further, federal courts themselves are not typically described as particularly speedy or efficient, thus the fact of this procedural change alone may prove to be a drag on the SEC's enforcement settlement income stream as the number of settlements or cases decreases.

The SEC has historically had many enforcement mechanisms at its disposal, thus *Jarkesy* is not likely to significantly impact its regulatory practices of bringing or settling enforcement in federal courts and administrative tribunal overall. Prior to Dodd-Frank, the SEC brought its civil cases against non-registrants in federal court, and it has continued to do for many cases since that time, against registrants and non-registrants. What remains to be seen is the impact of two Supreme Court opinions directly following *Jarkesy*, namely, *Loper Bright*, and *Corner Post*, which limit federal agency rulemaking and open them to constitutional challenges to their authority to make rules and interpret the law. *Corner Post*, decided shortly after *Jarkesy*, extended the timeframe in which challengers may bring such suits. *Loper Bright*, decided on July 1, 2024, overruled the longstanding doctrine of "Chevron deference" which required a court to defer to an agency's reasonable interpretation of the laws that it administers. While neither

opinion directly impacts the SEC's enforcement authority, the agency may be forced to expend or even divert precious resources to defend its authority in the wake of these opinions.

While the results of the *Jarkesy* decision are yet to be seen, the application of the opinion itself is somewhat limited in scope. It does not undo any existing settlements or vacate any ALJ orders. However, it does prevent the SEC from seeking civil penalties in its own tribunals for securities fraud going forward. Legal challenges may increase steadily as registrants and industry participants are emboldened to bring lawsuits that would not have been deemed likely to succeed in a prior climate. Just how large the pool of challengers and how successful they may be also remains to be seen. In the meantime, the SEC has many avenues to continue regulating and enforcing fraud under the securities acts in furtherance of its mission and mandate.

Securities and Exchange Commission v. Jarkesy et. al. –  
[https://www.supremecourt.gov/opinions/23pdf/22-859new\\_kjfm.pdf](https://www.supremecourt.gov/opinions/23pdf/22-859new_kjfm.pdf) (June 27, 2024)

Loper Bright Enterprises et al v. Raimondo – [https://www.supremecourt.gov/opinions/23pdf/22-451\\_7m58.pdf](https://www.supremecourt.gov/opinions/23pdf/22-451_7m58.pdf) (June 28, 2024)

Corner Post, Inc. v. Board of Governors of the Federal Reserve System –  
[https://www.supremecourt.gov/opinions/23pdf/22-1008new\\_8n5a.pdf](https://www.supremecourt.gov/opinions/23pdf/22-1008new_8n5a.pdf) (July 1, 2024)