

## Supreme Court requires agencies to bring fraud claims and other common law claims in federal court

July 3, 2024 | Client Update | 4-minute read

In *SEC v. Jarkesy*, the Supreme Court held that the SEC must bring fraud claims seeking penalties in federal court instead of administrative proceedings because defendants are entitled to a jury trial under the Seventh Amendment. The Court analogized the SEC's claims to common law fraud claims. Other agencies will be affected, but the scope is uncertain.

### Overview of decision

Before 2010, the SEC had to go to federal court to seek penalties against unregistered parties (i.e., not broker-dealers, investment advisers, or people associated with either). That changed in 2010 with the passage of the Dodd-Frank Act, which authorized the SEC to impose civil penalties in proceedings held before its own administrative law judges (ALJs), which could be appealed to the SEC's commissioners. Several litigants in recent years have challenged the constitutionality of those proceedings on multiple grounds.

In a June 27 opinion written by Chief Justice Roberts in *SEC v. Jarkesy*,<sup>1</sup> the Court held that an SEC fraud claim seeking a penalty must be filed in federal court, not in an administrative proceeding.<sup>2</sup> Because SEC penalties for fraud are aimed at punishment or deterrence, claims seeking such a remedy are "legal in nature" and analogous to common law fraud actions.<sup>3</sup> The Court held that Mr. Jarkesy was entitled to a jury because the Seventh Amendment right to a jury applies to claims akin to common law claims, including by seeking remedies that only a common law court could enforce.<sup>4</sup>

The Court rejected the SEC's argument that agency adjudications of statutory claims are covered by the "public rights" exception to the Seventh Amendment, which permits Congress to authorize an agency to decide a matter outside of an Article III court if the matter "historically could have been determined exclusively by [the executive and legislative] branches."<sup>5</sup> According to the Court, because the SEC's fraud claims were "in the nature of an action at common law," they implicated private, rather than public, rights and could be adjudicated only in an Article III court.<sup>6</sup>

Justice Gorsuch wrote a separate concurring opinion, in which Justice Thomas joined, to emphasize his view that the Court's decision was compelled not only by the Seventh Amendment but also by Article III and the Due Process Clause of the Fifth Amendment.<sup>7</sup> Justice Gorsuch reasoned that the Due Process Clause required a right to a jury trial because the penalty the SEC sought would deprive Mr. Jarkesy of property.<sup>8</sup>

Justice Sotomayor dissented, joined by Justices Kagan and Jackson. The dissent concluded that SEC fraud claims are within the public rights exception because "a matter of public rights arises 'between the government and persons subject to its authority in connection with the performance of the constitutional functions of the executive or legislative departments.'"<sup>9</sup> The dissent said that "the doctrine's heartland consists of claims belonging to the Government," including the SEC's suit against Mr. Jarkesy.<sup>10</sup>

### Takeaways

Because the SEC has radically scaled back its use of administrative proceedings for contested actions in recent years—due to multiple ongoing constitutional challenges to those proceedings—the immediate impact of the decision on SEC enforcement actions may be limited.

However, a key question is whether courts will apply the *Jarkesy* ruling to other types of government claims akin to common law claims, including both other types of SEC claims and claims by other federal agencies. The SEC pursues many other types of claims for rule violations that do not involve fraud, including claims against broker-dealers, investment advisers, and other regulated entities. The SEC also brings non-fraud claims against public companies, such as for inadequate accounting or disclosure controls. There also are some claims that the SEC can pursue only in administrative proceedings (for instance, Rule 102(e) bars against accountants, lawyers, and other professionals). If future courts were to determine that these types of claims also involve private rights, the SEC might be forced to bring them in federal court as well, or, while unlikely, forgo certain such claims entirely, absent legislative intervention. Especially where complex regulatory requirements are at issue, it would be a meaningful loss for the SEC's enforcement program if it were unable to litigate those claims before ALJs with deep experience with those rules.

Other federal agencies' use of administrative proceedings is likely to be implicated as well. To the extent other agencies use administrative proceedings to pursue claims that are akin to common law claims, those actions now seem more vulnerable to a similar constitutional challenge. The FDIC, CFPB, and Federal Communications Commission, among other agencies, currently use administrative adjudication, including in at least some cases to seek civil penalties. Although some non-fraud claims will likely fall within the "public rights" exception to the Seventh Amendment right to a jury, courts are likely to apply *Jarkesy's* broad reasoning to require other agencies to bring common law-type claims in federal court rather than agencies' own administrative proceedings. Some agencies that use administrative proceedings, however, do not have the ability to go directly to federal court. It is unclear how courts will deal with that situation.

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<sup>1</sup> No. 22-859, 2024 WL 3187811 (June 27, 2024).

<sup>2</sup> *Id.* at \*7.

<sup>3</sup> *Id.* at \*9–10.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at \*10.

<sup>7</sup> *Id.* at \*17 (Gorsuch, J., concurring).

<sup>8</sup> *Id.* at \*22.

<sup>9</sup> *Id.* at \*32 (Sotomayor, J., dissenting) (quoting *Crowell v. Benson*, 285 U. S. 22, 50 (1932)).

<sup>10</sup> *Id.*