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Client Alert

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Financial Services Regulation in the post-Jarkesy World

On June 27, 2024, the U.S. Supreme Court issued its opinion in *Securities and Exchange Commission v. Jarkesy*. By a 6-3 vote, the Supreme Court affirmed the Fifth Circuit's ruling, holding that the Seventh Amendment prohibits the SEC from bringing securities fraud claims in its in-house administrative proceedings when the SEC seeks civil monetary penalties.

The Supreme Court's decision may not have significant impact on the SEC's current practice. For the past several years, the SEC has almost exclusively brought its litigated actions in federal district court. That said, *Jarkesy* may very well call into question other federal agencies' use of in-house administrative proceedings to extract civil monetary penalties, including those agencies that operate in parallel to the SEC.

This is particularly true for banking regulators. A number of federal banking regulatory agencies rely—at times exclusively—on in-house proceedings before administrative law judges (ALJs) to resolve litigated claims. For many of these agencies, they do not have the option—which the SEC had—of bringing their claims in federal district court. These agencies span the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the Board of Governors of the Federal Reserve System ("FRB"), to the National Credit Union ("NCUA"). Additionally, the Public Company Accounting Oversight Board ("PCAOB") is likely impacted. As discussed in this Alert, there are already cases percolating in federal court that may impact these agencies' practice.

SEC v. Jarkesy

The issue resolved in *Jarkesy* was straightforward: Does the Seventh Amendment right to a jury trial apply when the SEC seeks civil monetary penalties for securities fraud? A majority of the Court answered this question, "yes." The majority concluded that the antifraud provisions the SEC enforces are akin to common law fraud, and that the so-called "public rights" exception did not apply.[1] Notably, the Court declined to address the other aspects of the Fifth Circuit's holding, which concerned the appointment and removal of ALJs as well as the process for the SEC's determination whether to proceed in its in-house forum versus federal district court.[2]

The Court focused its analysis on the remedies the SEC sought. Because the SEC was seeking to impose a civil monetary penalty, the majority held that the SEC's chosen remedy was "all but dispositive."[3] That is because civil monetary penalties are the type of remedy available to and enforced by courts of law. The majority also emphasized that the SEC sought civil monetary penalties to punish or deter the wrongdoer, not as a means of restoring the status quo.[4]

The majority confirmed its conclusion by reference to the "close relationship" between federal securities fraud and common law fraud.[5] Notably, the majority did not require exacting precision between a federal securities fraud claim and common law fraud, observing that the two species of fraud are not "identical," with federal securities fraud "narrower" in some respects, and "broader" in other respects.[6]

The majority concluded by rejecting the SEC's reliance on the "public rights" exception to the Seventh Amendment. In general, the "public rights" exception allows Congress to assign to an agency the ability to adjudicate when those rights historically have been determined exclusively by the executive and legislative branches.[7] The majority found this exception inapplicable. When considering the "substance of the suit, not where it is brought, who brings it, or how it is labeled," the majority easily rejected the SEC's reliance on the doctrine.[8] The majority emphasized that the SEC's action "resembles a traditional legal claim," such that "its statutory origins are not dispositive" and that the claim was a "common law suit in all but name."[9]

The dissent warned that the majority's holding would have far-reaching impacts on federal agencies, saying, "the constitutionality of hundreds of statutes may now be in peril, and dozens of agencies could be stripped of their power to enforce laws enacted by Congress."[10]

The Anticipated Impact on the SEC and Other Regulatory Agencies

For individuals and entities currently facing SEC scrutiny, the decision in *Jarkesy* is less than monumental. To avoid delay and uncertainty while *Jarkesy* has been winding its way to the Supreme Court, the SEC has been bringing its more substantial or litigated enforcement cases in federal district court while tending to rely more frequently on its in-house proceedings for settled matters.[11] In the wake of the *Jarkesy* decision, this is likely to continue.

But *Jarkesy* casts serious doubt on other federal regulatory agencies' use of their in-house proceedings, particularly those that regulate the financial industry. Numerous federal agencies, principally those that regulate the banking industry, including the OCC, the FDIC, the FRB, and National Credit Union ("NCUA") rely on their in-house administrative proceedings to levy civil monetary penalties and other punitive penalties against entities and individuals.

These bodies seek to extract civil monetary penalties to punish and deter misconduct—a central component of the majority's decision in *Jarkesy*—through in-house proceedings that lack the hallmarks of the procedural and substantive safeguards afforded in federal courts. On that front, these agencies' decision to seek to impose civil monetary penalties via in-house adjudication stands at significant risk of future challenge. We expect to see these issues work their way through the court system in the very near term. There are a number of cases pending where litigants have made arguments under *Jarkesy* to challenge the ability of the OCC and FDIC (and other agencies) to use their in-house proceedings to levy civil monetary penalties. Among the cases is a Fifth Circuit case challenging the FDIC's imposition of civil monetary penalties, which had been stayed pending the Supreme Court's decision in *Jarkesy*.[12] Other litigants have made similar claims, and we should expect these to continue.[13]

Importantly, unlike the SEC, many of these other regulatory agencies are not authorized by statute to initiate civil actions in federal district court. Until Congress acts to address this issue, these agencies must determine whether to proceed with an in-house action for civil monetary penalties, which will undoubtedly face constitutional scrutiny in federal court. This could result in creativity by these agencies to alter the form or nature of their remedies to cast them as equitable, not legal. It also may lead to agencies requesting parties' consent to in-house proceedings through the carrot of confidentiality, which may be appealing to litigants in some cases.

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[1] *Sec. & Exch. Comm'n v. Jarkesy*, No. 22-859, 2024 WL 3187811, at *1 (U.S. June 27, 2024). The Supreme Court resolved this matter following a decision by the U.S. Court of Appeals for the Fifth Circuit, which had held that the SEC's adjudication of antifraud claims before an administrative law judge violated the Seventh Amendment right to a jury trial, the nondelegation doctrine, and the Take Care Clause of Article II.

[2] *Id*.

[3] *Id*. at *2.

[4] *Id*.

[5] *Id*. at *10.

[6] *Id*.

[7] *Id*.

[8] *Id*. at *14.

[9] *Id*.

[10] *Id.* at *45 (Sotomayor, J., dissenting).

[11] Outside of settled matters, the SEC has also continued to use its administrative forum for those causes of actions or violations for which there is not defined jurisdiction within the federal court system, such as SEC Rule of Practice 102(e) proceedings and failures to supervise and associational bars under Section 15(b) of the Securities Exchange Act of 1934 and Section 203 of the Investment Advisers Act of 1940.

[12] *See Burgess v. Whang*, No. 22-11172 (5th Cir. 2023).

[13] *See, e.g.*, *Bonan v. FDIC*, No. 4:23-cv-00008-HEA, 2023 WL 156852 (E.D. Mo. 2023) (Motion for Temporary Restraining Order and Preliminary Injunction to prevent initiation of administrative judicial proceedings denied and matter dismissed).