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SEC Enforcement Matters

Jarkesy and *Loper*: Bombshells or Busts?

By Eric R. Nitz and Kenneth E. Notter III, *MoloLamken LLP*

Much ink has been spilled on the recent decision by the U.S. Supreme Court (Court) in SEC *v.* *Jarkesy*, with some commentators proclaiming that the decision signals the end of the administrative state and others dismissing it as having few practical consequences. This article discusses the Court's decision in *Jarkesy*; the implications for the SEC and other agencies, such as the CFTC, as well as for pending and future enforcement actions; and what *Jarkesy*, when read together with *Loper Bright Enterprises v. Raimondo* (*Loper*), means for the future of the SEC and its approach to rulemaking and enforcement.

For more on *Jarkesy* and the lower court decisions, see "Common Law Fraud and SEC *v. Jarkesy*: The Key Issue Underlying the Questions Presented" (Mar. 28, 2024); "Agency Power and Adjudication: The Government Seeks Supreme Court Review of *Jarkesy v. SEC*" (Jun. 8, 2023); "A Jury of Your Peers: Fifth Circuit Ruling in *Jarkesy v.* SEC Broadly Expands the Right to a Jury Trial for SEC Actions" (Jul. 21, 2022); and "Fifth Circuit Decision Could Hamstring SEC Enforcement Abilities" (Jun. 9, 2022).

The *Jarkesy* Decision

In 2013, the SEC initiated enforcement proceedings against hedge fund manager George Jarkesy, Jr., for alleged securities fraud. Although the SEC could have pursued the same allegations in federal court, it opted to proceed with an administrative action before an administrative law judge (ALJ), who found that Jarkesy had committed securities fraud. The SEC imposed a $300,000 civil penalty and $685,000 in disgorgement.

The dispute reached the Court, calling for it to decide whether Congress violated the Seventh Amendment of the Constitution by authorizing the SEC to seek civil penalties for securities fraud in a proceeding before an ALJ, rather than before a jury in federal court.

The Majority Opinion

The Court's answer was "yes." In an opinion by Chief Justice John Roberts – and joined by five other Justices – the Court held that the Seventh Amendment entitles a defendant to a jury trial in federal court whenever the SEC seeks civil penalties for securities fraud.

In reaching that conclusion, the Court first considered whether an action seeking civil penalties for securities fraud implicates the Seventh Amendment's guarantee of trial by jury in all "[s]uits at common law." It does, the Court explained, because the right to a jury trial "is not limited to the common-law forms of action recognized when the Seventh Amendment was ratified." Rather, it extends to all suits that are "legal in nature" as opposed to those based on equity or admiralty jurisdiction.

An action seeking civil penalties for securities fraud is "legal in nature" and thus implicates the Seventh Amendment for two main reasons, the Court held. First, the SEC sought civil penalties – the "prototypical common law remedy" meant to punish wrongdoers – from Jarkesy. That Congress limited the availability and conditioned the size of civil penalties on factors tied to "the culpability of the defendant and the need for deterrence" and that the SEC need not return any money to victims also showed that SEC civil penalties are a "punitive" legal remedy rather than an equitable one designed to restore the status quo.

See "What Remedies and Relief Can Fund Managers Expect in SEC Enforcement Actions?" (Jan. 10, 2019).

Second, the "close relationship" between securities fraud and common-law fraud confirmed that conclusion. Those actions both target misrepresentations or omissions of material facts as Congress intended by using "'fraud' and other common law terms," thus linking securities fraud to its common-law counterpart. That link, the Court explained, was not broken by the differences between the actions, such as the fact that common-law fraud requires the deception to inflict harm, while securities fraud may not require a showing of harm to be actionable by the SEC.

Because the proceeding against Jarkesy was "legal in nature," it could be tried before an ALJ only if the "public rights" exception to the Seventh Amendment applied. That doctrine holds that, notwithstanding the Seventh Amendment, Congress may assign adjudication of disputes involving certain congressionally created public rights to ALJs. But as an unwritten exception, the public rights doctrine must be applied with care, the Court warned, lest the exception "swallow the rule."

Noting the "arcane distinctions and confusing precedents" in this area, the majority did not profess to resolve every inconsistency. Instead, the Court identified a core set of actions that the public rights exception – however far it extends – can almost never reach: "suits in the nature of an action at common law."

The suit against Jarkesy was just such a suit, beyond the reach of the public rights exception, continued the majority. As the Court's earlier opinion in *Granfinanciera, S.A v. Nordberg* made clear, what "matters is the substance of the action," not whether it arises from a "newly fashioned regulatory scheme." An action sounding in fraud "is a common lawsuit in all but name," concluded the Court, and therefore must be tried before a jury in an Article III court.

The Court distinguished its prior decision in *Atlas Roofing Co. v. Occupational Safety & Health Review Commission*. Unlike the securities fraud violations in *Jarkesy*, explained the Court, the cause of action in *Atlas Roofing* – employer violations of occupational health and safety standards – was not borrowed from the common law. Because the claims were "unknown to the common law," Congress could assign adjudication of the claims to a non-Article III tribunal. *Atlas Roofing* thus was

not controlling here. For the same reasons, the Court declined Jarkesy's invitation to overrule *Atlas Roofing*.

Justice Gorsuch's Concurrence

Justice Neil Gorsuch (joined by Justice Clarence Thomas) wrote separately to point out that adjudicating Jarkesy's case before an ALJ implicated not only the Seventh Amendment but also Article III and the Due Process Clause.

Article III vests the federal courts with the "judicial Power" over "all cases, in Law and Equity." The Constitution thus prohibits Congress from "withdraw[ing] from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity." For Justice Gorsuch, the unavoidable conclusion is that the SEC's in-house adjudication system offends Article III in addition to the Seventh Amendment.

For much the same reasons, Justice Gorsuch added, the SEC's in-house system of adjudication would seem to violate the Due Process Clause because "due process" typically means "*judicial* process." And because the penalty the SEC sought to impose would deprive Jarkesy of property, "due process demands nothing less than the process and proceedings of the common law," he asserted.

Together, Justice Gorsuch wrote, Article III, the Due Process Clause and the Seventh Amendment erect "high walls and clear distinctions to safeguard individual liberty" from administrative proceedings without juries and the other traditional protections of Article III courts.

Justice Sotomayor's Dissent

Justice Sonia Sotomayor, joined by Justices Elena Kagan and Ketanji Brown Jackson, dissented. For the dissenters, the key fact was that the government brought the action against Jarkesy "as an injured sovereign." When that is true, the dissent argues, the Court's "longstanding precedent" unequivocally allowed agency adjudications of statutory claims for civil penalties – even for actions that are closely analogous to common-law claims.

According to the dissent, the majority erred by relying on cases in which the government was not a party in its sovereign capacity. Only in those circumstances was it relevant whether a right "is legal in nature." That is why, in the dissent's view, *Granfinanciera* did not control: because it did not involve the government acting in its sovereign capacity. Rather, the relevant precedent was the Court's decision in *Atlas Roofing*, which allowed Congress to assign adjudication of new statutory obligations enforceable through civil penalties to a non-Article III adjudicator without a jury.

In the dissent's view, the majority's disregard for precedent "pulls a rug out from under Congress" by upsetting "centuries of settled Government practice" allowing agencies to adjudicate actions for regulatory fines and other civil penalties. By the dissent's count, some "two dozen agencies" do just that. Forcing all those actions into federal courts amounted to a judicial "power grab," arrogating to the Court policy decisions that had long belonged to Congress, the dissent argues.

The *Loper* Decision

A day after holding that certain SEC claims must be brought in federal court and cannot be adjudicated by ALJs, the Court in *Loper* held that, under the Administrative Procedure Act (APA), federal courts are not required to defer to an agency's reasonable interpretation of an ambiguous statute and must instead apply their own independent judgment. So-called "*Chevron* deference," the Court concluded, was no more.

The Majority Opinion

In 1984, the Court decided *Chevron U.S.A. Inc. v. Natural Resources Defense Counsel, Inc.* *Chevron* set forth a two-step framework for considering whether agency action complied with the agency's authorizing statute:

1. A court should first consider whether a statutory term was ambiguous. If unambiguous, it would apply the plain and clear meaning of the statutory text.
2. If the statutory text was silent or ambiguous with respect to the specific issue under consideration, however, the court was required to defer to the agency's reasonable interpretation of the statute – even if the court itself would have interpreted the statute differently.

The principle underlying *Chevron* was that agencies have expertise in their designated areas, and therefore courts should defer to that expertise when interpreting ambiguous language in the laws pertaining to their work.

Loper overruled *Chevron*. Federal courts "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority," the Court held. They cannot "defer to an agency interpretation of the law simply because a statute is ambiguous."

To reach that conclusion, the Court began with first principles. Article III of the Constitution, the Court explained, vested the judiciary with authority to resolve "cases" and "controversies," a power that included the responsibility to construe ambiguous statutes and, as Chief Justice Thurgood Marshall wrote in *Marbury v. Madison*, to "say what the law is." In doing so, courts could – and, throughout the nation's history, did – take into account the executive branch's views concerning statutory meaning. However, the Court stressed, judges "certainly would not be bound to adopt the construction given by a head of a department."

The APA codified that understanding and was "enacted . . . 'as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices,'" continued the Court. For that reason, the APA provides that "the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action." The APA, the Court added, "prescribes no deferential standard for courts to employ in answering those legal questions," an omission the Court found "telling" because other provisions of the APA mandated deferential review of

agency determinations of fact. Consequently, the Court held that the APA requires courts to independently determine the meaning of statutes.

The legislative history of the APA supports that view. The House and Senate reports on the legislation explained that "questions of law are for courts rather than agencies to decide." Those who supported the legislation in Congress agreed with that approach as well. In short, the two-step *Chevron* framework – which *required* judicial deference when confronted with ambiguous statutory text – does not comport with the APA, the Court held.

That does not mean agency views have no place in the judiciary's analysis of the statutory text, the Court acknowledged. Courts remain free to consult – as they routinely have – "the interpretations of those responsible for implementing particular statutes" in determining the meaning of statutory text. Executive interpretations issued contemporaneously with the passage of the statute, the Court added, might be "particularly useful."

Moreover, Congress can enact statutes that vest agencies with a "degree of discretion" and can even delegate to an agency the authority to "give meaning to a particular statutory term." Thus, "[w]hen the best reading of a statute is that it delegates discretionary authority to an agency, the role of the reviewing court under the APA is, as always, to independently interpret the statute and effectuate the will of Congress subject to constitutional limits," held the Court.

Finally, the Court considered whether the doctrine of *stare decisis* required continued adherence to *Chevron*, ruling that it did not. Describing *Chevron* as "fundamentally misguided," the Court noted that the decision failed to account for the text of the APA and has, over the years, proven "unworkable."

Justices Thomas and Gorsuch each wrote a concurring opinion. Justice Thomas wrote separately to underscore his view that *Chevron* violated the Constitution's doctrine of separation of powers. Justice Gorsuch, meanwhile, separately addressed the doctrine of *stare decisis*, explaining why that doctrine supported the Court's decision to overrule *Chevron*.

For more on *Chevron*, see "Does the *Digital Realty* Decision Represent a Sea Change for Whistleblowers or Merely More of the Same?" (Mar. 15, 2018).

Justice Kagan's Dissent

Justice Kagan, joined by Justices Sotomayor and Jackson, dissented. Describing *Chevron* as a "cornerstone of administrative law," the dissent explains that that decision appropriately "allocat[es] responsibility for statutory construction between courts and agencies." By requiring courts to first identify whether Congress clearly spoke on the issue under consideration – and, when it does, to follow that direction – *Chevron* remained faithful to the constitutional and historical precedents requiring courts to apply and interpret the law, the dissent argues.

Chevron's second step, in which courts would defer to reasonable agency interpretations in the absence of clear direction from Congress, was appropriate because it was "rooted in a presumption of legislative intent," continued the dissent. Congress recognizes that statutes may have ambiguity or gaps and, in the context of regulatory statutes involving administrative agencies, would prefer

agencies to fill those gaps rather than the courts. Administrative agencies are best suited to resolve those ambiguities and fill those gaps because they have the requisite technical expertise and long-standing experience with the regulatory program, argues the dissent.

According to the dissent, nothing in the APA requires a different result. The statutory text neither explicitly authorizes a deferential standard of review nor explicitly requires a de novo standard of review. Thus, *Chevron* deference did not conflict with the APA.

Finally, the dissent disagreed with the majority's application of *stare decisis*. Because Congress could overrule *Chevron* by statute – and has chosen not to for more than 40 years – the decision was entitled to "*stare decisis*'s strongest form of protection," asserts the dissent.

Implications of the Court's Decisions

Taken together, *Jarkesy* and *Loper* give courts a far greater role to play in cases involving administrative regulation. *Jarkesy* demands that certain actions be adjudicated in federal court, while *Loper* results in less deference to the agency once there.

Both cases could have gone much further, however. In *Jarkesy*, the Court had granted certiorari to consider two other questions on which a loss for the SEC might have been even more disruptive. A ruling that Congress impermissibly delegated its legislative power by allowing the SEC to decide whether to proceed before an ALJ or in federal court, for example, could have imperiled every statute allowing agencies a choice between in-house adjudication and federal courts. Even agency enforcement structures that had previously survived Seventh Amendment challenges may have become vulnerable to nondelegation challenges.

Loper, too, could have gone further. That decision expressly affirmed that courts *may* consider an agency's interpretation of a statute, and it noted that Congress may, consistent with nondelegation principles, vest agencies with some authority to give meaning to statutory terms.

Future cases will reveal just how far the limits of the Court's holdings in *Jarkesy* and *Loper* reach. Yet there is no denying that these decisions will reshape the administrative enforcement landscape.

Where and When to Bring Enforcement Actions

With respect to *Jarkesy*, for example, dozens of agencies impose civil penalties through administrative proceedings, as the dissent notes. Challenges to those enforcement schemes are already in progress and will undoubtedly rely on *Jarkesy*.

Jarkesy may also influence the SEC's enforcement decisions. Confronted with limited resources, the agency may forgo seeking civil penalties in cases in which it does not believe penalties are recoverable (such as, because of the defendant's limited resources) or in cases the SEC perceives as involving less serious misconduct. Doing so would likely allow the agency to proceed in the administrative forum and avoid the costs and burdens of civil litigation in federal court.

The SEC may also refer more securities fraud cases to the DOJ for criminal prosecution. By doing so, the SEC can avoid the drain on its resources, allowing the DOJ to do the heavy lifting of advancing the litigation. In that way, *Jarkesy* may expose defendants who otherwise may have escaped with a civil fine to criminal liability.

For defendants who do find themselves facing criminal mail or wire fraud charges, however, *Jarkesy* offers some potentially good news. Both the majority and dissent in *Jarkesy* agreed that common-law civil fraud requires injury to the victim. And the decisions the majority cited leave no doubt that deception that induces victims to merely enter, or continue with, a transaction they otherwise would have avoided does not supply the required injury for common-law fraud.

That concept matters because the federal mail and wire fraud statutes punish only schemes to defraud – *i.e.*, schemes that, if completed as intended, would be fraud at common law. As a result, *Jarkesy* supplies some support for the position that there can be no scheme to defraud for purposes of proving mail or wire fraud unless the scheme is one that, if successful, would inflict harm on the victim. In other words, the object of the "scheme" must be to cause such harm. Several lower courts, however, have expanded the fraud statutes to reach even those "schemes" in which, by design and operation, the victim gets what he or she pays for. With *Jarkesy*'s confirmation that civil common-law fraud requires actual injury, that position now appears at risk. Therefore, the subjects of current enforcement actions involving such charges may be able to invoke *Jarkesy* to get those charges dismissed.

Interpretation of the Securities Laws

Loper could have significant consequences for how the courts construe the securities laws. After *Loper*, courts will no longer defer to an agency's interpretation of statutory language. That lack of deference could influence, for example, whether new types of asset classes – such as digital assets and cryptocurrencies – qualify as "securities" that the SEC may regulate, "commodities" regulated by the CFTC or neither (or something else entirely).

Indeed, because digital assets did not exist when Congress enacted many financial regulatory statutes, pre-*Loper* courts applying the *Chevron* two-step framework would have been likely to find the statutory gaps or ambiguities that ultimately trigger *Chevron* deference. After *Loper*, however, courts will simply apply their independent judgment when considering whether the statutory terms "security" and "commodity" reach cryptocurrencies and other digital assets.

See "Digital Assets Remain Top of Mind for SEC Division of Examinations" (Apr. 8, 2021); and "U.S. District Court Rules That Virtual Currencies Are Commodities Under the Commodity Exchange Act" (Apr. 12, 2018).

The SEC's recent rules governing special purpose acquisition companies similarly might receive heightened scrutiny in the absence of *Chevron* deference. As with challenges to other regulations, courts will approach the question of whether those regulations conform to Congress's statutory authorization with a clean slate.

Jarkesy and *Loper* have altered the dynamic between the courts and administrative agencies, giving courts greater opportunity for intervention. The magnitude of that shift, however, remains to be seen.

See "SEC and CFTC 2023 Enforcement Results: Robust Enforcement Activity and Significant Monetary Sanctions" (Jan. 18, 2024).

Eric R. Nitz is a partner at MoloLamken LLP, where he represents clients in white-collar investigations and regulatory enforcement; complex civil litigation; and appellate litigation, briefing appeals in appellate courts across the country and in the Supreme Court.

Kenneth E. Notter III is an associate at MoloLamken LLP, where he focuses on white-collar criminal matters and complex commercial disputes.

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