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Client Alert

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Supreme Court: SEC Cannot Force Defendants in Civil-Penalty, Antifraud Enforcement Actions To Litigate Before the Commission Instead of Federal Court

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The U.S. Supreme Court recently decided *SEC v. Jarkesy*. That decision held that individuals subject to U.S. Securities and Exchange Commission (SEC or Commission) enforcement actions in which the SEC seeks civil penalties for violations of the antifraud provisions of the federal securities laws have a Seventh Amendment jury trial right. The decision therefore forbids the SEC from unilaterally forcing such defendants to adjudicate their defense in the SEC's administrative courts.

Background

The *Jarkesy* decision focused on the three "antifraud" provisions of the federal securities laws: Section 17(a) of the Securities Act, Section 10(b) of the Securities and Exchange Act, and Section 206 of the Investment Advisers Act (Antifraud Provisions). Although these provisions are worded differently, the Court described them generally as prohibiting "misrepresenting or concealing material facts." The SEC's Enforcement Division enforces the Antifraud Provisions. The Enforcement Division can bring an action to enforce the Antifraud Provisions in either of two forums. The first option is the Commission itself. In that case, the SEC (or its designee) adjudicates the case (without a jury), decides discovery disputes, and determines the scope and form of permissible evidence. The second option is federal court. In federal court, a jury (typically) finds the facts, a federal judge decides legal questions and discovery disputes, and the Federal Rules of Civil Procedure and Evidence govern. The Dodd-Frank Wall Street Reform and Consumer Protection Act gave the SEC the choice to bring enforcement actions in either forum.

The SEC brought an enforcement action against Jarkesy and the investment advisor entity he managed, alleging that they violated the Antifraud Provisions. The SEC forced Jarkesy and his investment advisor entity to defend the action before its administrative body, and ultimately levied a $300,000 civil penalty against Jarkesy and the investment advisor he managed, among other things. Jarkesy appealed the decision. He argued that he was entitled to a jury under the Seventh Amendment and the SEC's unilateral decision to decide the matter in its own tribunal violated that right. The United States Court of Appeals for the 5th Circuit agreed and overturned the penalty. The Commission appealed that decision.

Holding

The Supreme Court posed the question in Jarkesy's appeal as follows: Does the Seventh Amendment entitle a defendant to a jury trial when the SEC seeks civil penalties against him for securities fraud? The Court answered that question in the affirmative.

The Court found that the Seventh Amendment's jury guarantee covered the SEC's claims under the Antifraud Provisions because they resembled common law claims for fraud. The Court found the fact that the SEC was seeking civil penalties against Jarkesy was of particular importance because "money damages are the prototypical common law remedy."

The Court also rejected the SEC's claim that its enforcement action fell under the so-called public rights doctrine. That doctrine allows certain types of cases–typically those involving the collection of government revenue, the imposition of tariffs, relations with Indian tribes, and the administration of public lands–to be tried outside federal courts by the executive or legislative branches instead. However, the Court again found that the common law nature of the SEC's claims controlled the issue and held that the public rights doctrine did not apply.

Having found that Jarkesy had a Seventh Amendment right in defending against the SEC's claims and that no exception applied, the Court affirmed the 5th Circuit's decision overturning the SEC's enforcement penalty against him.

Takeaways

The Court's holding in *Jarkesy* limits the SEC's ability to bring actions under the Antifraud Provisions in its own administrative court. Defendants in such cases have the right to defend themselves before a jury, in federal court. This does not mean, however, that all SEC enforcement actions are required to proceed in federal court. Not all SEC enforcement actions resemble common law claims to the same extent as those seeking to enforce the Antifraud Provisions. Courts will ultimately decide what types of enforcement actions must be pursued in federal court as opposed to those that can still proceed before the Commission.

Moreover, a defendant, even in a prosecution under the Antifraud Provisions, can still waive its Seventh Amendment jury trial right. Such a waiver could make sense, for example, in a case where the Commission seeks to initiate a prosecution and then settle it immediately–the typical procedure the SEC follows when the parties decide to settle violations following an investigation but before any claims are asserted.

For further information, guidance, or clarity on the *Jarkesy* decision, please contact the authors of this article or reach out directly to your regular Lowenstein Sandler contact.

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