

# Jarkesy May Thwart Consumer Agencies' Civil Penalty Power

By **Brian Goodrich, Ceijenia Cornelius and Morgan Delabar** (August 15, 2024)

On June 27, in *U.S. Securities and Exchange Commission v. Jarkesy*, the U.S. Supreme Court held that the SEC must bring civil penalty actions for securities fraud in federal court where the defendant is entitled to a jury under the Seventh Amendment to the U.S. Constitution, and cannot do so in an internal, administrative hearing.

The court's decision in *Jarkesy* not only implicates future SEC administrative adjudications, but those of other agencies that operate similarly — in particular, federal consumer protection regulators such as the Federal Trade Commission, the Federal Deposit Insurance Corp. and the Consumer Financial Protection Bureau.

Following a brief overview of relevant portions of the court's *Jarkesy* opinion, this article analyzes and explores how *Jarkesy* might affect agencies other than the SEC. Specifically, it analyzes the extent to which the opinion may stymie regulators' efforts to levy civil monetary penalties in consumer protection enforcement actions.

## Background

The core issue presented to the court in *Jarkesy* was whether the Seventh Amendment entitles a defendant to a jury trial when the SEC seeks civil penalties for securities fraud pursuant to the Securities Exchange Act.

The Supreme Court, in an opinion written by Chief Justice John Roberts, ultimately determined that the Securities Exchange Act's statutory prohibition on fraud is akin to common-law fraud, and that common-law claims may entitle a defendant to have claims against them decided by a jury.

## ***Imposing Penalties Meant to Deter or Punish Triggered Seventh Amendment Protections***

The court opined that the Seventh Amendment provides defendants with the right to have a jury adjudicate a common-law claim brought against them if the remedy sought by the government agency is "legal in nature."

In *Jarkesy*, the SEC sought civil penalties. To determine whether civil penalties were legal in nature, the court looked at whether the remedy was designed to punish or deter the wrongdoer, or whether it was intended solely to restore the status quo.



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To conduct its analysis, the court applied a six-factor test, and analyzed the relationship between the causes of action brought by the SEC and similar common-law claims of fraud.

Ultimately, the court concluded that the civil penalties sought in *Jarkesy* went beyond restitution, and were instead meant to deter and punish the defendant. Therefore, the court held that the defendant in *Jarkesy* had a right to a jury trial.

### ***Public Rights Exception Not Applicable to Agency Claims Resembling Common-Law Fraud***

The court also found that the public rights exception to the Seventh Amendment did not apply. Under this doctrine, Congress can create public rights and assign their adjudication to non-Article III tribunals, such as administrative agencies, without violating a defendant's right to a jury trial.

However, if a suit involves a defendant's private rights, or if the claims closely resemble common-law claims, then the matter presumptively concerns private rights, and adjudication by an Article III court is mandatory.

The court noted that the SEC's case was brought under the anti-fraud provisions of the federal securities laws, and called for civil penalties that could only be enforced in courts of law. The court found those provisions to target the same basic conduct as common-law fraud, use the same terms of art, and operate pursuant to similar legal principles.

Thus, the court determined that the action in *Jarkesy* involved a matter of private rather than public right, and thereby triggered the defendant's Seventh Amendment's right to a jury.

## **Analysis**

### ***Potential Applicability to Other Agencies***

The court's analysis in *Jarkesy* leaves the door open for challenges to other similar, statutory frameworks that are sometimes enforced in administrative settings, such as the FTC Act, the Federal Deposit Insurance Act and the Dodd-Frank Act.

Due to these laws' similarities to the Securities Exchange Act, it is likely that there will be similar challenges should the agencies responsible for enforcing those laws utilize administrative hearings to impose penalties. Each law broadly forbids certain types of abusive, unfair or deceptive conduct that could be considered akin to common-law fraud.

Additionally, the aforementioned agencies sometimes file cases or claims against individual defendants before administrative law judges appointed by the agency, who have broad prosecutorial discretion and are often empowered to issue binding judgments.

For example, the FTC Act and the conduct it regulates could be analogous to the acts and conduct referenced in *Jarkesy*. Penalties and restitution that the FTC has historically sought from companies and individuals sometimes are in addition to restitution — meaning that a court would likely view the purpose of such civil penalties as punishment or deterrence.

It is unclear, however, whether FTC Act claims are more akin to statutory claims than the common-law claims brought in *Jarkesy* — meaning that an argument that the FTC Act claims fit within the public rights exception to a defendant's right to a jury could exist.

Similarly, the Supreme Court's holding in *Jarkesy* could implicate the Dodd-Frank Act, which permits the CFPB to punish individuals for their involvement in alleged unfair, deceptive or abusive acts or practices. Moreover, the Dodd-Frank Act mirrors the Securities Exchange Act in that it instructs the CFPB to consider the defendant's culpability when deciding the size of the penalty, and has tiers of damages — some of which give the CFPB discretion to seek penalties beyond just restitution.

The FDIC also brings enforcement actions against insured institutions and their officers, directors, controlling shareholders and certain employees that may include civil money penalties. The actions that the FDIC seeks to punish through these enforcement actions share many commonalities with common-law causes of action such as breach of fiduciary duty, fraud and gross negligence.

Further, the civil money penalties that are assessed by the FDIC are separate from, and assessed under a different analysis from, any monetary restitution. This framework also aligns with the court's reasoning in *Jarkesy* that led to the conclusion that a target of an enforcement action is entitled to a trial by jury.

Notably, a case brought by the FDIC in the U.S. District Court for the Northern District of Texas, *Burgess v. Whang*, has been stayed pending resolution of *Jarkesy*. How that case proceeds may be a bellwether as to the challenges that agencies can expect moving forward in a post-*Jarkesy* world.

### ***Potential Impacts on Agencies and Regulatory Enforcement***

The *Jarkesy* opinion comes as possible good news for defendants. Federal courts offer defendants several advantages over an administrative hearing.

For example, federal courts afford defendants protections under the Federal Rules of Civil Procedure and the Federal Rules of Evidence, which include limitations on the government's use of evidence, and permit defendants greater opportunity to engage in their own discovery efforts. Furthermore, federal courts typically offer defendants greater opportunities to appeal adverse decisions than decisions issued by an ALJ.

In a post-*Jarkesy* legal landscape, agencies may attempt to dress up penalties as remediation, or opt for injunctive relief over civil penalties. Agencies may also be more likely to use federal courts as their forum of choice in order to avoid such challenges.

However, agencies would do so at the risk of defendants' attempts to remove cases to federal courts with judges that disfavor federal authority. Agencies could also need to commit greater resources in order for the agency to prosecute a federal jury trial successfully, which could ultimately result in less agency enforcement.

### **Conclusion**

Only time will tell how much of a thorn the *Jarkesy* opinion will be in the side of federal consumer protection regulators seeking civil monetary penalties. However, significant potential exists for this opinion to fuel efforts by defendants — or conservative members of the judiciary — to fence in agencies' authority and power.

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