

MODULE 7 FINAL BLOG: EMERGING TOPICS FALL 2024

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Jarkesy's Implications for State Civil Administrative Enforcement Proceedings

Practice Alert

U.S. Const. amend VII (1791)

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

In *SEC vs. Jarkesy et al.*, 603 U.S. ____ 2024, No. 22-859 slip op. (Jun. 27, 2024), the Court held that the Seventh Amendment guarantee of a jury trial in common law civil cases applied to federal administrative enforcement proceedings where monetary penalties were sought for securities fraud. Commentators immediately speculated on the ruling's meaning for civil administrative enforcement proceedings before other federal agencies. The case's effect on state civil administrative enforcement proceedings is less obvious, but no less significant. Does this ruling affect state administrative enforcement proceedings? This blog asserts that Jarkesy's holding and reasoning could prove persuasive to state courts in states where the right to a jury trial in civil cases is given constitutional protection like the Seventh Amendment.

SEC vs. Jarkesy: "Sea change" in Administrative Enforcement Proceedings

The Supreme Court's June 27, 2024, 6 to 3 ruling in *SEC vs. Jarkesy* held that the Seventh Amendment right to a jury trial in civil cases applied to SEC administrative enforcement proceedings seeking civil penalties for securities fraud. Many court watchers and legal commentators believe the case has broad applicability to other federal agency internal administrative enforcement proceedings and may render them unconstitutional. Indeed, Justice Sotomayor in her dissent, joined by Justice Kagan and Justice Jackson, stated "[t]oday's decision is a massive sea change. Litigants seeking further dismantling of the 'administrative state' have reason to rejoice in their win." *Jarkesy* at p. 35 (2024). "...[T]here are, at the very least, more than two dozen agencies that can impose civil penalties in administrative proceedings..." which are implicated by the decision. *Id.* at p. 36. I agree that the majority's reasoning is not confined to the SEC's internal administrative enforcement process and will likely apply to all federal agencies.

A related issue is whether the Jarkesy decision will have any impact on state administrative enforcement proceedings? Although the Seventh Amendment doesn't currently apply to the states, most states also have civil jury trial guarantees enshrined in their constitutions. Many state constitutional provisions are consistent with the Seventh Amendment guarantee and have been interpreted and analyzed by state courts similarly. Thus, the Supreme Court's reasoning in *Jarkesy* may prove persuasive to these similarly situated state courts in the context of a jury trial demand in an enforcement proceeding before a state administrative agency. States without Seventh Amendment-like protections may prove to be fertile ground for renewed attempts to

incorporate the Seventh Amendment through the Fourteenth Amendment rendering its protection applicable to the states. Because of the potential effect on individual litigants, and the regulatory scheme in general, lawyers on both sides of an enforcement case should consider anew whether a jury trial in civil enforcement proceedings is required or should be demanded.

Jarkesy Facts

The essential facts of *Jarkesy* are as follows: The SEC levied civil securities fraud claims against Jarkesy, and Patriot28, an investment advisor managed by Jarkesy. The claims stemmed from conduct occurring between 2007 and 2010 where \$24 million in investment funds was raised from 120 “accredited” investors. “According to the SEC, Jarkesy and Patriot28 misled investors in at least three ways: (1) misrepresenting the investment strategies that Jarkesy and Patriot28 employed, (2) by lying about the identity of the funds’ auditor and prime broker, and (3) by inflating the funds’ claimed value so that Jarkesy and Patriot28 could collect larger management fees.” *Jarkesy* at pp. 4-5. The civil fraud claims were brought based on “...the antifraud provisions of the Securities Act, the Securities Exchange Act, and the Investment Advisors Act...” *Id.* at p. 5.

Jarkesy Analysis and Holding

The Court traced the history of SEC enforcement under the various depression-era securities acts, concluding that the remedy sought determined which forum was chosen. “Except in cases against registered entities, the SEC could obtain civil penalties only in federal court.” *Id.* This forum limitation changed with the passage of the Dodd-Frank Act in the wake of the 2008 financial crisis. “In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) 124 Stat. 1376. That Act ‘ma[de] the SEC’s authority in administrative penalty proceedings coextensive with its authority to seek penalties in Federal Court.’” *Id.* at p. 4. The SEC now had a choice of forum to pursue civil penalties in enforcement matters. “In other words, the SEC may now seek civil penalties in federal court, or it may impose them through its own in-house proceedings.” *Id.*

In Jarkesy’s case “...the SEC opted to adjudicate the matter itself rather than in federal court...” resulting in “...a civil penalty of \$300,000 against Jarkesy and Patriot28...” *Id.* at p. 5. Jarkesy and Patriot28 appealed. “A divided panel of the Fifth Circuit granted their petition and vacated the final order” ...ultimately holding “...that the agency’s decision to adjudicate the matter in-house violated Jarkesy’s and Patriot28’s Seventh Amendment right to a jury trial.” *Id.* The Fifth Circuit panel ruled the SEC’s action unconstitutional on three separate grounds: Seventh Amendment violation, non-delegation doctrine violation, and separation of powers violation based on executive supervision of the administrative law judges. The Supreme Court agreed to hear the case.

The Court, relying on *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) and *Tull v. United States*, 481 U.S. 412 (1987), applied a two-part test to what it considered “...a straightforward question, whether the Seventh Amendment entitles a defendant to a jury trial when the SEC seeks civil penalties against him for securities fraud.” *Id.* at p. 6. The two-part test is summarized as follows: (1) Does the government’s action implicate the Seventh Amendment? (2) If so, does the “public rights” exception to Article III jurisdiction apply? *Id.* Though the test

is described as two-part, a yes answer to part (1) precludes consideration of part (2).

In applying the test, the Court concluded the Seventh Amendment was implicated and noted the analysis turns on whether a claim is one of common law or one based in equity. The Court discusses the historical distinction between law and equity but emphasizes that it is not limited to the historical distinction. Quoting *Curtis v. Loether*, 415 U.S. 189 (1974) “In construing this language, we have noted that the right is not limited to the ‘common-law forms of action recognized’ when the Seventh Amendment was ratified...As Justice Story explained, the Framers used the term ‘common law’ in the Amendment ‘in contradistinction to equity, and admiralty, and maritime jurisprudence...The Amendment therefore ‘embraces[s] all suits which are not of equity or admiralty jurisdiction, whatever may be the peculiar form which they may assume.’” *Id.* at p. 8, (citations omitted). Further, “[t]he Seventh Amendment extends to a particular statutory claim if the claim is ‘legal in nature’...” and “...whether that claim is statutory is immaterial to this analysis.” *Id.* at 8, (citations omitted). “To determine whether a suit is legal in nature, we directed courts to consider the cause of action and the remedy it provides. Since some causes of action sound in both law and equity, we concluded that the remedy was the ‘more important’ consideration.” *Id.* (citations omitted).

The Court then concluded that, in the present case, the remedy is a civil monetary penalty, and “...is all but dispositive.” *Id.* “While monetary relief can be legal or equitable, money damages are the prototypical common law remedy.” *Id.* The central question is whether the civil monetary penalty is designed to “punish” or “deter” conduct, or “restore the status quo.” *Id.* (quoting *Tull*). “Applying these principles, we have recognized that ‘civil penalt[ies are] a type of remedy at common law that could only be enforced in courts of law.’” *Id.* In other words, civil monetary penalties are punishment, thus a remedy at law not equity. Summary of part one of the test: Is the Seventh Amendment implicated? Is the claim one at law or equity? Focus on the remedy. Is the remedy designed to punish or return to the status quo? If to punish, then the action is one at law, and the Seventh Amendment is implicated. If remedial, or to return to status quo, then equity and the Seventh Amendment is not implicated.

Since the Court’s answer to part 1 of the test was yes, it did not need to apply part 2, whether the “public rights” exception applies. The “public rights” exception is best understood in the context of the separation of powers between the three branches of government. Can Congress remove a matter from consideration by the Judicial branch, and vest it in the executive branch?

“Public rights” exceptions have been found in the context of the collection of revenues, immigration, trade matters, Indian tribe relations, public land administration, and public benefit payments. *Id.* at 15 and 17. Common to all of the “public rights” exceptions is an emphasis on the uniqueness of the particular action. “Without such close attention to the basis for each asserted application of the doctrine, the exception would swallow the rule.” *Id.* at 17. Based on the Court’s analysis it is hard to imagine a “public rights” exception applicable to a government action against a private party seeking punishment in the form of civil monetary penalties.

Based on the foregoing facts and analysis, the Court affirmed the Fifth Circuit and held “[a] defendant facing a fraud suit has the right to be tried by a jury of his peers before a neutral adjudicator.... We do not reach the remaining constitutional issues and affirm the ruling of the Fifth Circuit on the Seventh Amendment ground alone.” *Id.* at 27.

Applicability of *Jarkesy* to Other Federal Agencies

Soon after the Court issued its opinion in *Jarkesy* many major law firms published practice alerts warning of its potential applicability to all federal agencies. With near unanimity, these commentators warn of the broad impact of the reasoning of the Court in the context of internal civil enforcement proceedings before federal agencies. For example, K & L Gates writes that “...the decision will inevitably spur future challenges to other federal agency enforcement efforts relating to claims with ties to the common law or to claims for civil penalties.”¹ Womble Bond Dickinson states, “[t]o be sure, *Jarkesy* is a significant decision. But its impact likely will be greater outside of the SEC – on other agencies that seek civil penalties in litigated administrative proceedings.”² White & Case opines that “[t]he decision is the latest in the growing trend by courts to curtail the reach of the administrative state, and is likely to have impacts far beyond the SEC.”³ Finally, Williams Mullen asserts that “[t]he Supreme Court’s decision in *Jarkesy* represents a critical juncture in the evolution of administrative law and the enforcement power of federal agencies. For EPA, an extension of this ruling could significantly alter the way it conducts enforcement actions, particularly those involving civil penalties.”⁴ All agree that *Jarkesy* represents a major change in administrative law potentially affecting all federal agencies.

Applicability of *Jarkesy* to State Agency Administrative Enforcement

To date, the Seventh Amendment has not been made applicable to the states through the doctrine of incorporation.⁵ However, many states have similar civil jury trial protections enshrined in their constitutions. As one commentator notes: “Some states also incorporate jury trial rights in their state constitutions that are coextensive with the federal constitution. It remains to be seen how those processes will be impacted by *Jarkesy*, but in theory the same reasoning could apply.”⁶ For those who practice in a state with civil jury trial constitutional protections, *Jarkesy* could prove to be very persuasive authority for a state court interpreting the state constitutional provision especially if the state’s caselaw includes a distinction between law and equity claims. Also, it is not hard to imagine a case arising where the U.S. Supreme Court would consider anew whether to incorporate the Seventh Amendment to the states which do not currently have civil jury trial rights in their constitutions.

The necessary analysis is best illustrated with a hypothetical. Your state’s department of environmental quality administers an internal civil enforcement process for state and federal environmental law violations. Civil penalties are routinely sought from defendants to punish the behavior and deter noncompliance. The proceedings take place before the agency board of commissioners, executive director, or an agency administrative law judge. Agency lawyers prosecute the case. The Defendant demands a jury trial due to the punitive nature of the civil

¹ K&L Gates: *Jarkesy*’s Impact On Agency Enforcement Proceedings: Potential Implications For The SEC And Beyond; <https://www.klgates.com/Jarkesys-Impact-on-SEC-In-House-Proceedings-Potential-Implications-for-SEC-Enforcement-and-Beyond-7-3-2024>

² Womble Bond Dickinson: SEC v. *Jarkesy*: How Impactful Is It Really On The SEC’s Enforcement Program? <https://www.womblebond Dickinson.com/us/insights/alerts/sec-v-jarkesy-how-impactful-it-really-secs-enforcement-program>

³ White and Case: Supreme Court rules SEC use of in-house tribunals is unconstitutional in potentially far-reaching

decision, <https://www.whitecase.com/insight-alert/supreme-court-rules-sec-use-house-tribunals-unconstitutional-potentially-far-reaching>

⁴Williams Mullen: The Supreme Court's Decision in SEC v. Jarkesy and Its Implications For EPA's Administrative Enforcement, <https://www.williamsmullen.com/insights/news/legal-news/supreme-courts-decision-sec-v-jarkesy-and-its-implications-epas>

⁵Incorporation Doctrine, available at: https://www.law.cornell.edu/wex/incorporation_doctrine ⁶Arent Fox Schiff: SEC v. Jarkesy's Implications For Environmental Enforcement Actions, <https://www.afslaw.com/perspectives/environmental-law-advisor/sec-v-jarkesys-implications-environmental-enforcement>

penalties. Is the Defendant entitled to a jury trial? Answering the following questions will help frame the issues:

First: determine whether your state has a constitutional provision addressing civil jury trial protections. Does the provision mirror the Seventh Amendment? Is the language broad requiring further analysis? If narrow is it dispositive?

Second: does the state's caselaw employ the distinction between law and equity claims in interpreting the provision? Are the law and equity claims limited to those existing at the time the state constitution was adopted?⁷ There may be a dearth of caselaw in the civil context, rendering *Jarkesy* persuasive.

Third: is the remedy sought designed to restore the status quo, or is it designed to punish or deter? In our hypothetical the facts indicate that civil monetary penalties are being sought to punish or deter. The penalties are not restorative or meant as restitution. The claim is one of law, not equity.

Fourth: Can a public vs. private rights distinction be made? Is this a public right such that the state courts would recognize an exception to the jury trial requirement? Using the hypothetical and the above questions it is easy to see how *Jarkesy's* reasoning, even though it technically does not apply to a state matter, could be used to persuade a state court to find that a jury trial is required, especially if the case is one of first impression. Lawyers on both sides of the issue should frame their arguments with the assumption that *Jarkesy* applies.

Conclusion:

Jarkesy is an important decision affecting all federal agency internal administrative enforcement efforts. The case will also likely prove persuasive to state courts considering state constitutional civil jury trial protections. The analysis will turn on whether a state recognizes the distinction between cases at common law and those at equity. The remedy sought will be the key in determining the question of law or equity. This blog concludes that *Jarkesy* has broad implications for federal and state agency environmental enforcements and suggests that both agency and defense counsel should be familiar with the argument.

⁷ See *Dep't of Envtl. Quality v. Morley*, 314 Mich. App. 306, 309 (2015) holding that the cause of action must have been known to common law at the time of ratification of the state constitution. "Because wetland protection is not a cause of action known to the common law, but is instead a new cause of action created by statute, there is no constitutional right to a jury trial..." Also note that this case was pre-*Jarkesy*.