

ALERT

# Supreme Court Holds That Federal Agencies May Seek Punitive Money Penalties Only Before A Jury

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Last week the U.S. Supreme Court held in *SEC v. Jarkesy* that a defendant in a securities fraud suit has the right to be tried by a jury in an Article III court, rather than before an agency's own tribunal. The Court's analysis largely echoed an *amicus* brief Wiley submitted on behalf of several national communications trade associations.

The case arose when the U.S. Securities and Exchange Commission (SEC) alleged that Jarkesy violated various securities laws, held an adjudication before its own in-house tribunal, found Jarkesy liable, and imposed a \$300,000 civil money penalty. Jarkesy then sued in federal court, arguing that the SEC violated the Seventh Amendment. That Amendment provides that in "[s]uits at common law, ... the right of trial by jury shall be preserved." Following proceedings in the lower courts, the Supreme Court took the case and agreed with Jarkesy. Its analysis proceeded in two steps.

*First*, the Court held that the Seventh Amendment was implicated because the SEC proceeding is a suit at common law. That language, the Court explained, extends to a particular claim if it is "legal in nature." And that inquiry turns on the "cause of action" and the "remedy it provides," with remedy being "the more important consideration."

Here, the remedy was "all but dispositive" because the SEC "seeks civil penalties." Because it is a form of "monetary relief" that serves "either retributive or deterrent purposes," that remedy can "only be enforced in courts of law." In other words, because the SEC imposes civil penalties "to punish the defendant rather than to restore the

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victim," the remedy is "legal rather than equitable." And the "close relationship between federal securities fraud and common law fraud" "confirm[ed]" that the action is legal.

*Second*, the Court held that the "public rights" exception did not apply. That exception allows Congress to assign adjudication to an administrative agency when "the political branches ha[ve] traditionally held exclusive power over [a] field." But because the exception "has no textual basis in the Constitution" and "must therefore derive instead from background legal principles," courts must pay "close attention to the basis for each asserted application of the doctrine" to ensure that it is based in "historical practice" such as "centuries-old rules."

Here, the Court held, the SEC advanced traditional legal claims. The pertinent statutory provisions "provide civil penalties," which is a "punitive remedy" that can "only be enforced in courts of law." And they "target the same basic conduct as common law fraud, employ the same terms of art, and operate pursuant to similar legal principles." The Court distinguished *Atlas Roofing*, a 1977 case holding that the public-rights exception applied to a regulatory scheme created by the Occupational Safety and Health Act. That statute, the Court explained, "did not borrow its cause of action from the common law" but established standards resembling "a detailed building code."

The Court's holding was informed by fundamental separation of powers principles. Under those principles, the judicial power of the United States "cannot be shared with the other branches." That meant that *Jarkesy* is "entitled to a jury trial in an Article III court." Concurring, Justice Gorsuch emphasized that the Seventh Amendment "operates together with Article III and the Due Process Clause of the Fifth Amendment to limit how the government may go about depriving an individual of life, liberty, or property."

### **Implications and Considerations**

*Jarkesy* could have profound impact. The opinion suggests that civil money penalties are punitive by nature, and that punitive money penalties require Article III process and a jury trial. Across the spectrum of federal agencies, therefore, future targets of enforcement actions seeking civil penalties will likely argue that the Constitution entitles them to a judicial forum and jury trial. Under the Supreme Court's *Axon* doctrine, defendants may immediately bring lawsuits in federal court invoking the judicial forum and jury trial rights to stop ongoing agency proceedings. They also may use the threat of a lawsuit to negotiate favorable settlement terms with the agency. Or they may choose to waive their rights in exchange for more favorable terms in a consent decree. And some agencies do not have statutory authority to bring enforcement actions in court.

*Jarkesy* also could serve as a spur to congressional and agency reform. Lobbying efforts could persuade Congress that it needs to provide particular agencies with an avenue to seek penalties directly in court to avoid litigation over the extent to which adjudication in their in-house tribunals are constitutional. In the communications context, lobbying efforts could include calls for a more comprehensive reform package that includes earlier opportunities for targets to challenge FCC letters of inquiry, and other reforms highlighted in a recent enforcement reform white paper authored by Wiley partner Thomas M. Johnson, Jr., co-chair of the

firm's Issues and Appeals Practice.

The decision's parameters will likely take some time to play out in the lower courts. One early candidate to test the limits of the decision will be ongoing challenges to the FCC's "location-based services" orders. AT&T has already keyed up this issue in a petition to the Fifth Circuit. In the meantime, regulated entities should evaluate whether and when to preserve a Seventh Amendment argument in pending and future anticipated enforcement proceedings.