

Jarkesy Wins Relief From ALJ Control After Years of Fighting for His Right to a Jury Trial

“*Jarkesy v. SEC*” will have significant implications for defendants in other SEC administrative proceedings in the Fifth Circuit and potentially beyond, and for other federal agencies that utilize ALJs.

BY REED BRODSKY AND MICHAEL L. NADLER

Like it has with many others, the U.S. Securities and Exchange Commission filed administrative proceedings against George Jarkesy Jr. in 2013. Unlike many others, however, Mr. Jarkesy did not sit back and accept the SEC’s authority to proceed before an administrative law judge (ALJ). He initially challenged the constitutionality of the SEC proceedings in federal district court, but the U.S. Court of Appeals for the D.C. Circuit held that Mr. Jarkesy had to first raise his arguments before the commission itself, which he did. Years of litigation followed, until the U.S. Court of Appeals for the Fifth Circuit last week granted him the relief that he had long sought.

On May 18, 2021, the Fifth Circuit held in *Jarkesy v. SEC* that the SEC violated the Constitution by filing an enforcement action seeking monetary penalties for fraud before an ALJ. Specifically, it held that Jarkesy and the other defendants were deprived of their right to a jury trial; that Congress impermissibly delegated legislative powers by granting the SEC unfettered discretion in choosing whether to bring matters before ALJs; and that restrictions on the removal of SEC ALJs constricted the president’s constitutionally mandated oversight over inferior government officers. Beyond its immediate impact on the SEC, *Jarkesy* will have significant implications for defendants in other SEC administrative proceedings in the Fifth Circuit and potentially beyond, and for other federal agencies that utilize ALJs.



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Juries. The Seventh Amendment guarantees that “the right of trial by jury shall be preserved” for all “Suits at common law.” The courts have distinguished between claims involving “private rights,” which would have been decided by a jury when the amendment was ratified, and cases involving “public rights”—those rights created by statute and enforced by the government in its sovereign capacity—which need not be heard by a jury. In practice, the line between “public rights” and “private rights” is often contested. Because “the SEC’s enforcement action is akin to traditional actions at law” for fraud, and because monetary penalties could only have been imposed by a jury at common law, *Jarkesy*

held that securities fraud actions require a jury trial.

Jarkesy appears to be a matter of first impression at the appellate level on this issue. That is not altogether surprising, since the SEC has only been empowered to bring fraud actions seeking monetary penalties before ALJs since enactment of the Dodd-Frank Act in 2010. Earlier appellate cases affirmed that the SEC can seek equitable relief from ALJs, such as *SEC v. Rinds*, in which the U.S. Court of Appeals for the Ninth Circuit held that jury trials are not required for disgorgement of illicit profits, and *Imperato v. SEC*, in which U.S. Court of Appeals for the Eleventh Circuit held that an ALJ could permanently bar a defendant from various market activities. While *Imperato* and *Rinds* might appear to be in tension with *Jarkesy* on first glance, they are, in fact, consistent with *Jarkesy* because its ruling concerning jury trials was expressly tied to the SEC's pursuit of monetary penalties, rather than equitable remedies. As a result, *Jarkesy* will likely be relied on in future challenges to other agencies' ability to seek monetary penalties for fraud and related claims before ALJs.

Non-Delegation. Article I of the Constitution provides that “[a]ll legislative Powers herein granted shall be vested in a Congress,” which cannot transfer that authority to other government actors. Although Congress may grant regulatory power to agencies, it must provide an “intelligible principle” according to

which the regulator shall exercise that authority. Yet Congress authorized the SEC to decide whether to bring actions before ALJs or in federal courts without expressly providing such guidance. *Jarkesy* held that this was an impermissible grant of legislative authority, empowering the SEC to “decide which defendants should receive certain legal processes” that obtain only in court proceedings—“a power that Congress uniquely possesses.”

This is perhaps the most far-reaching of *Jarkesy*'s rulings. Like the SEC, many other agencies have discretion to bring actions in federal court or before ALJs. Notwithstanding that the Supreme Court last found a law unconstitutional under the non-delegation doctrine in 1935, following *Jarkesy* non-delegation challenges to such discretion will likely proliferate. Moreover, in *Gundy v. United States* four sitting Supreme Court justices recently indicated interest in revisiting the non-delegation doctrine. Seen in that context, *Jarkesy* or its progeny may well provide the Supreme Court with the opportunity to resuscitate that doctrine.

Removal. Under Article II of the Constitution, the president must “take Care that the Laws be faithfully executed,” which requires having sufficient power over all executive-branch agencies, including the appointment and removal of certain officials. Because SEC ALJs are “sufficiently important to executing the laws that the Constitution

requires that the President be able to exercise authority over their functions,” *Jarkesy* held that statutory restrictions on the president's ability to remove SEC ALJs from office are unconstitutional, a ruling that may impact many agencies with similar ALJ removal protections. In so holding, *Jarkesy* also created a potential circuit split, as the U.S. Court of Appeals for the Ninth Circuit rejected a similar challenge to removal protections for Department of Labor ALJs in *Decker Coal v. Pehringer*.

Retroactivity. Lastly, *Jarkesy* will invite challenges to matters currently before the SEC ALJs and retroactive challenges to matters previously decided by SEC ALJs. The SEC will surely argue that finality doctrines preclude reopening earlier matters already resolved. Nevertheless, only time will tell whether the judiciary proves sympathetic to claims that injunctions still in effect or financial penalties already paid should be vacated on the grounds that the defendants were unconstitutionally deprived of their jury trial rights and forced to defend themselves before judges whose authority was constitutionally infirm.

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