HAWKINS

The Regulatory Impact of Jarkesy, Loper Bright, and Corner Post

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Introduction

This Hawkins Update reviews three recent Supreme Court decisions – *Jarkesy*, *Loper Bright*, and *Corner Post*.[1] Although these decisions are likely to substantially affect the rulemaking and enforcement activities of federal administrative agencies generally (including the Department of the Treasury and the Internal Revenue Service), we discuss the cases more specifically with respect to certain potential impacts on the Securities and Exchange Commission (the "SEC").

No Civil Penalties in Administrative Proceedings

In *Jarkesy*, the Supreme Court considered the manner in which the SEC brings enforcement actions and, more specifically, whether the Seventh Amendment entitles a defendant to a jury trial when the SEC seeks civil penalties for securities fraud.

In 2011, the SEC commenced an enforcement action against Jarkesy and his investment advisory firm, Patriot28, LLC ("Patriot28"). The SEC alleged that Jarkesy and Patriot28 misled investors in connection with the launch and management of two investment funds by: (i) misrepresenting the funds' investment strategies; (ii) hiding the identity of the funds' auditor and prime broker; and (iii) inflating the funds' claimed value to generate larger management fees. In initiating the enforcement action, the SEC alleged that these actions violated the antifraud provisions of the Securities Act, the Securities Exchange Act, and the Investment Advisers Act. The SEC sought remedies that included civil penalties. The SEC adjudicated the matter in-house, found that Jarkesy and his firm had committed securities violations, and levied a civil penalty of $300,000. Jarkesy and Patriot28 appealed.

The SEC has statutory authority to bring certain enforcement actions in two distinct ways. It can file suit in federal court, or the SEC can choose to adjudicate the matter itself. The forum selected dictates certain aspects of the litigation.

In federal court, a jury finds the facts, a federal judge presides, and the Federal Rules of Evidence and the ordinary rules of discovery govern the litigation. When the SEC adjudicates the matter in-house, there are no juries. An SEC administrative law judge[2] ("ALJ") presides, while its Division of Enforcement prosecutes the case. The SEC or an ALJ also finds facts and decides discovery disputes, and the SEC's Rules of Practice govern.

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which authorized the SEC to impose civil penalties through its own in-house proceedings. Before that legislative change, the SEC could only obtain civil penalties in federal court. The heart of this case is not the SEC's choice to bring the case as an in-house proceeding, but rather the imposition of a punitive monetary civil penalty in such a proceeding.

In appealing the decision, Jarkesy and Patriot28 argued that the SEC's decision to adjudicate the matter in-house violated their Seventh Amendment right to a jury trial. The Fifth Circuit agreed and vacated the SEC's final order. The Fifth Circuit also found that Congress had violated the non-delegation doctrine[3] by authorizing the SEC to choose whether to litigate actions seeking civil penalties in-house or in federal court. The SEC petitioned the Supreme Court for review.

The Supreme Court agreed with the Fifth Circuit, holding that: (i) the Seventh Amendment entitles a defendant to a jury trial when the SEC seeks civil penalties for securities fraud; (ii) the SEC's antifraud provisions replicate common law

fraud; and (iii) it is well established that common law claims must be heard by a jury. A statute providing for administrative agency enforcement in response to alleged behavior that would have been actionable at common law cannot limit the availability to defendants of Seventh Amendment safeguards that would apply in a common law action.

The majority opinion in *Jarkesy* characterized its principal disagreement with the dissenting Justices by emphasizing that a defendant at risk of civil monetary penalties based upon alleged fraudulent practices "has the right [under the Seventh Amendment] to be tried by a jury of his peers before a neutral adjudicator [in a court of law]," asserting that "the dissent would permit Congress to concentrate the roles of prosecutor, judge, and jury in the hands of the Executive Branch."[4] However, as the Court explained, courts of equity fall outside the scope of the Seventh Amendment and the SEC will likely continue to use the administrative forum for matters involving equitable remedies like disgorgement, which involve non-punitive monetary penalties.[5]

Moving Forward – Implications for the SEC. It remains to be seen how the *Jarkesy* decision will impact the SEC's enforcement activities, especially those instituted as administrative proceedings. Below are some considerations.

- **Broader Jury Trial Rights:** The Court based its ruling on a finding that the civil penalties in *Jarkesy* are "designed to punish and deter, not to compensate"[6] and are of "a type of remedy at common law that could only be enforced in courts of law."[7] Although *Jarkesy* focused on fraud and civil penalties, the Court's conclusion that a jury trial remains required in an enforcement case that could have been brought as a common law action, or its equivalent,[8] suggests a broader application. There may be other types of claims that have been brought as administrative proceedings that might be similarly entitled to Seventh Amendment protections.
- **Choice of Forum/Changes in Enforcement Activity**: As noted above, the *Jarkesy* enforcement action dates to 2011. The SEC seems to have since reduced the number of administrative enforcement actions it brings (especially as they relate to contested matters). If *Jarkesy* results in the need for more federal court actions for matters involving civil penalties, the SEC could be even more discerning about which actions to pursue. Federal court proceedings are also litigated in a more public manner than administrative proceedings.
- **Less of Stacked Deck**: In a concurring opinion in *Jarkesy*, Justice Gorsuch noted that defendants have often fared better in federal court than in administrative proceedings. If the SEC is required to bring its enforcement actions that seek civil penalties in federal court, the defendants are more likely to find success in those proceedings, as they will have access to more procedural protections that are unavailable in administrative proceedings. In addition to access to a jury trial, certain discovery and evidentiary rules are available in federal court that are not applicable to administrative proceedings.

More generally, the decision calls into question the future function of SEC in-house proceedings. In the context of recent Court cases facilitating challenges to administrative agency authority, including those reviewed below, it can be expected that courts will continue to scrutinize the independence, impartiality, appointment, and tenure of ALJs.[9] Prior challenges to the SEC's use of ALJs had already prompted the SEC to shift away from administrative proceedings beginning in 2018 (at least with respect to matters involving civil penalties). That is likely to continue in light of the *Jarkesy* decision and might dampen the overall impact of this ruling.

Chevron Deference Jettisoned

In *Loper Bright*, the Supreme Court overturned the *Chevron* doctrine,[10] a landmark administrative law doctrine that had governed federal court review of certain administrative agency determinations for almost 40 years, holding that federal courts "must exercise [their] independent judgment in deciding whether an agency has acted within its statutory authority."[11] By contrast, under the *Chevron* doctrine, federal courts were required to defer to permissible agency interpretations of ambiguous, or arguably incomplete, provisions in the statutes those agencies administer.

Loper Bright involves fishing regulations. In 1976, Congress enacted the Magnuson-Stevens Fishery Conservation and Management Act (the "MSA"), which regulated fishing in the international waters off the U. S. coast and instituted

procedures for the management of fishery resources. The National Marine Fisheries Service (the "NMFS") administers the MSA under a delegation from the Secretary of Commerce.

The MSA established eight regional fishery management councils composed of representatives from the coastal States, fishery stakeholders, and the NMFS. One of the many rules and regulations established by the NMFS was a requirement that one or more observers be carried on board domestic vessels for the purpose of collecting data necessary for the conservation and management of the applicable fishery. Under certain circumstances, the businesses that operate in the fishery are required to pay for the observers. Loper Bright Enterprises, Inc. and certain other fishing boat operators with business in the Atlantic herring fishery challenged this rule, arguing that the MSA does not authorize NMFS to mandate that they pay for observers required by a fishery management plan.

The District Court concluded that the MSA unambiguously authorized this rule, but noted that even if there was an argument that there was an ambiguity in the statutory text, deference to the agency's interpretation would be warranted under *Chevron*. While the D.C. Circuit Court affirmed the lower court ruling, it found that the statute was ambiguous. In applying *Chevron*, the D.C. Circuit Court held that the NMFS had an interpretation of the statute that was at least reasonable, which *Chevron* required the court to accept. The fishing boat operators petitioned the Supreme Court for review, specifically to determine whether *Chevron* should be overruled or clarified.

The *Loper Bright* decision held *Chevron* deference to be inconsistent with the Administrative Procedure Act (the "APA"), [12] which the majority viewed as requiring courts to "exercise their independent judgment in deciding whether an agency has acted within its statutory authority"[13] in cases interpreting ambiguous statutory language purportedly mandating agency action. Accordingly, federal courts are no longer required to automatically defer to any agency determination that meets a relatively low "permissible" standard.[14] Rather, courts must independently decide such legal questions by applying their own interpretation based upon factors that the majority views as having been codified by the APA for such agency cases. In exercising such judgment, courts may seek aid from the interpretations of the agencies responsible for implementing particular statutes, which constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance consistent with the APA.[15]

As the Court noted, neither *Chevron* nor any of the Court's subsequent decisions attempted to reconcile its framework with the APA. In fact, the Court stated that *Chevron* cannot be reconciled with the APA by presuming that statutory ambiguities are implicit delegations to agencies.[16] As such, the more absolute deference in *Chevron*, which the *Loper Bright* majority characterized as demanding "that courts mechanically afford binding deference to agency interpretations," was overruled.[17]

It should be noted that neither *Chevron* nor *Loper Bright* relate to certain agency determinations, including factual determinations and rulemaking determinations that have been explicitly, and unambiguously, delegated by statute to the applicable agency.

Moving Forward – Implications for the SEC. In *Loper Bright*, the Supreme Court's decision to overturn *Chevron* has altered the ground rules for judicial review of administrative agency regulatory action. Statutory interpretations and rulemaking for federal agencies will be subject to heightened scrutiny when the statutory basis of agency action is challenged. The substantive impact of the *Loper Bright* decision will vary by specific agency, rule, and regulated person or project.[18] This includes SEC rulemaking and possibly certain aspects of its enforcement powers.

In recent years, the SEC has proposed rules on climate change, cybersecurity disclosure, and other far-reaching initiatives, as well as rules implementing numerous provisions of Dodd-Frank and other legislative directives. The Court's abandonment of the *Chevron* standard of judicial deference is expected to increase the likelihood of legal challenges to new and existing rules by regulated or otherwise affected persons. It may also improve the chances of success in such regulatory contests. This could reduce the certainty with which all affected persons may view adopted rules, as well-established rules and regulations could also be susceptible to judicial review.

The *Loper Bright* decision did not attempt to fully outline a new set of ground rules for federal court review of the legitimacy of agency rulemaking, leaving any doctrinal developments that might reduce the concerns of the type suggested in the prior paragraph to be developed in future cases. As the Court is at the start of this major doctrinal development, its course is likely to be unpredictable for some time. During this period, it may be further expected that legal standards affecting the practical ability of individual persons and groups of various kinds to seek rulemaking review, as well as the review standard, will vary between federal appellate circuits. In a post-*Chevron* world, there are legitimate concerns with the effects of forum shopping and varied federal court interpretations of the same statute and how that might impact the overall regulatory landscape.[19]

It seems possible that federal agencies, such as the SEC, may respond to this uncertainty by modifying their rulemaking process to seek more express statutory mandates and related legislative history – perhaps engaging in preliminary fact finding and policy formulation in order to support subsequent rulemaking. It also seems possible that Congress may respond to this uncertainty by modifying the APA, using the Congressional Review Act,[20] or enacting separate legislation.[21]

New Tolling Standard for Statute of Limitations in Administrative Agency Actions

In another recent Supreme Court decision, *Corner Post*, the statute of limitations for claims under the APA was considered. The plaintiff in *Corner Post* was a truckstop and convenience store that opened in 2018 and subsequently challenged a Federal Reserve Board rule adopted in 2010, which prescribed a formula for the maximum amount of certain "interchange fees" that a bank provider may charge merchants in connection with their customer's use of debit cards. The challenge was a facial one, claiming that the rule permitted higher bank fees than the statute permitted, rather than being based upon the specific application of the rule to the plaintiff.

The Supreme Court overruled the lower courts' dismissal of the complaint (and affirmation thereof), which was based on holdings that the complaint was time barred under the statute of limitations applicable to claims under the APA. Such reversal is based on the principle that the limitation period may only begin to run, with respect to a specific plaintiff, when that person is injured by the final agency action in question, rather than when the action itself became final. The opinion based this result upon a textual analysis of the provisions providing private causes of action under the APA, [22] which it had previously interpreted as requiring litigants to show an injury in fact by a final agency action,[23] and the general statute of limitation applicable to APA cases, which provides that the complaint in such an action must be filed "within six years after the right of action first accrues."[24]

Reasoning that the right of action with respect to a rule could not have accrued with respect to a regulated or otherwise affected person until it becomes subject to the rule, the majority opinion held that the statute of limitations was tolled until the plaintiff had become subject to it, even though all originally eligible plaintiffs were by then time barred. The Court also distinguished between "statutes of repose," which put an outer limit on the right to bring a lawsuit measured from the date of the defendant's last act or omission that constitutes the basis of the action (in the case of APA rulemaking, final rule adoption) , and "statutes of limitations," which create a time limit for bringing a lawsuit measured from the date when the claim accrued.[25] Statutes of limitations require plaintiffs to pursue diligent prosecution of known claims, while statutes of repose reflect a legislative judgment that a defendant should be free from liability after the legislatively determined period of time.[26]

In the absence of a Congressional response limiting the ability to file suit challenging federal administrative rules, it is apparent that the *Corner Post* decision will magnify the impact of decisions such as *Loper Bright* as its practical effect will be that most agency rulings will be continually subject to challenge by after-arising plaintiffs.

Conclusion

While the full impact of the *Jarkesy*, *Loper Bright*, and *Corner Post* rulings is unknown at this time, federal courts, administrative agencies, and Congress are likely to respond to the changes that these cases have initiated, with a renewed focus on the scope, implementation, and enforcement process of federal administrative law. As the Court further develops doctrine to implement these decisions in light of possible responses, it is clear that federal agency regulation has entered what appears likely to be an extended period of volatility and vacillation. As expressed by Justice Jackson's *Corner Post* dissent, the Court's recent rulings "invite and enable a wave of regulatory challenges," creating the possibility that well-established agency rules may be upended, once settled doctrines may be brought into question, and claims that were barred by statutes of limitations may again become actionable.[27] The federal regulatory landscape has changed. What happens next will depend upon the interplay of administrative, legislative, and judicial responses to these decisions and the next phase of regulatory contests.

[1] The cases analyzed in this Advisory are (i) *Securities and Exchange Commission v. Jarkesy* (603 U. S. ____ (2024); No. 22-859, 2024 U.S. LEXIS____) ("Jarkesy"), (ii) *Loper Bright Enterprises v. Raimondo*, 603 U. S. ____ (2024); No. 22-451, 2024 U.S. LEXIS 2882 ("Loper Bright") (along with the accompanying case *Relentless, Inc., et al. v. Department of Commerce, et al*, No. 22–1219); and (iii) *Corner Post v. Board of Governors of the Federal Reserve System*, 603 U. S. ____ (2024); No. 22-859, 2024 U.S. LEXIS 2885) ("Corner Post").

[2] According to the SEC's website:

ALJs serve as independent adjudicators who determine whether allegations against respondents in SEC enforcement proceedings are true. The judges conduct public hearings, issue subpoenas, hold conferences with parties, rule on motions, and rule on the admissibility of evidence. ALJs prepare an initial decision that sets forth factual findings and legal conclusions while determining whether sanctions are warranted.

For more information on the SEC's use of ALJs, see https://www.sec.gov/about/divisions-offices/office-administrative-law-judges.

[3] The non-delegation doctrine bars Congress from transferring its legislative power to another branch of government. While the lower court addressed this doctrine in its decision, the Supreme Court decision in *Jarkesy* did not reach this issue.

[4] *Jarkesy* at 27.

[5] *Id* at 9, noting that "while courts of equity could order a defendant to return unjustly obtained funds [(disgorgement)], only courts of law issued monetary penalties to 'punish culpable individuals'…[W]e have recognized that 'civil penalt[ies are] a type of remedy at common law that could only be enforced in courts of law.'"

[6] *Id*. at 9.

[7] *Id*. at 11.

[8] *Id.*

[9] See *Lucia v. SEC*, 138 S. Ct. 2044 (2018).

[10] *Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837 (1984).

[11] *Id.*

[12] Federal administrative law is largely found in Title 5 of the U.S. Code. The APA is codified as part of Chapter 5 – Administrative Procedure thereof. Several other chapters in Title 5 include corresponding aspects of the APA, such as Chapter 7 – Judicial Review, which are referred to in the cases discussed in this Advisory.

[13] *Loper Bright at 35*.

[14] *Chevron* at 843.

[15] *Id.* at 865. The Court had established general standards for permissive federal court reliance upon agency determinations shortly prior to introduction of the APA. See *Skidmore v. Swift & Co.,* 323 U.S. 134, 136-37 (1944).

[16] *Loper Bright* at 21.

[17] *Id.*

[18] This may result in considerable differences in the degree to which different financing programs or participants are affected. See "What The *Loper* Decision May Mean For U.S. Public Finance," S&P Global Ratings (August 21, 2024).

[19] One matter that warrants some attention is the debate over recent rulemaking by the Federal Trade Commission (the "FTC") regarding non-compete clauses in employment agreements. Pursuant to Sections 5 and 6(g) of the Federal Trade Commission Act (the "FTC Act"), the FTC issued the Non-Compete Clause Rule, which provides that it is an unfair method of competition (a violation of Section 5 of the FTC Act) for persons to, among other things, enter into non-compete clauses with workers on or after the rule's effective date. The rule will also impact certain existing non-compete clauses.

There have been several challenges to the Non-Compete Clause Rule. In one such case, Ryan LLC v. Federal Trade Commission, the U.S. District Court for the Northern District of Texas issued an order blocking the Non-Compete Clause Rule on August 20, 2024. The opinion cites *Loper Bright*, the overturning of the *Chevron* review standard, and the application of the APA review standard in blocking the FTC's implementation of the Non-Compete Clause Rule, stating that (i) the FTC promulgated the rule in excess of its statutory authority, and (ii) the rule is arbitrary and capricious (the APA review standard). Further, the District Court found Section 6 of the FTC Act to be a "housekeeping statute," which would apply to the implementation of agency organizational procedures or practices and not substantive rules.

In Section 5 of the FTC Act, Congress vested the FTC with the power to, among other things, prevent persons, partnerships, or corporations from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce. Section 6 of the FTC Act gives the FTC the power to make rules and regulations for the purpose of carrying out the provisions of [the FTC Act]. In support of its Non-Compete Clause Rule, the FTC stated that, based on its studies, public hearings, and investigations, it found that non-competes are unfair methods of competition that have limited the economic opportunities of workers bound by such clauses (approximately 30 million U.S. workers). Under *Chevron*, it seems likely that the Non-Compete Clause Rule survives judicial review. Under *Loper Bright*, such certainty is now in question. It may actually depend on where the case is filed and the political makeup of the particular district court.

[20] The Congressional Review Act currently provides a procedure for Congress to adopt a Joint Resolution to overturn a rule adopted by a federal agency, utilizing "fast track" procedures that do not require Senate cloture, within a finite period after the rule is adopted. See 5 U.S.C. §§801-808.

[21] Such legislation could take the form of the "Stop Corporate Capture Act," which has been introduced in the Senate and proposes to amend Title 5 of the U.S. Code to, among other things, require disclosure of conflicts of interest with respect to rulemaking and codify the *Chevron* doctrine.

[22] See 5 U.S.C. § 702, which provides, among other things, that a person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof, and 5 U.S.C. § 704, which provides, among other things, that an agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review.

[23] *Corner Post* at 4-5.

[24] *Id.* at 5. See also 28 U.S.C. § 2401(a), which provides, among other things, that every civil action commenced against the United States shall be barred unless the complaint is filed within six years after the right of action first accrues.

[25] *Corner Post* at 9-10.

[26] *Id.*

[27] *Id.* at 23.

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