
LEGAL UPDATES AND NEWS

Supreme Court Decision Signals Changes for Bank Agency Enforcement Processes

On June 27, 2024, the United States Supreme Court issued its [opinion](#) in *Securities and Exchange Commission v. Jarkesy*, a decision which will have important ramifications for banks and individuals facing enforcement actions by the federal banking agencies and the CFPB. This Client Alert covers the relevant considerations from the decision and the practical implications for any institution, director, or officer facing a potential federal bank agency enforcement action.

Background

In 2013, the SEC initiated an enforcement action against George Jarkesy, a hedge fund manager, and Patriot28, an entity Jarkesy managed and that served as the funds' investment adviser. The SEC alleged that Jarkesy and Patriot28 had violated the anti-fraud provisions of the Securities Act, the Securities Exchange Act, and the Investment Advisers Act. In the enforcement action, the SEC sought civil penalties and other remedies. The case was brought before an in-house administrative law judge (“ALJ”) at the SEC rather than in federal court. After receiving the ALJ's decision, the SEC issued a final order imposing a \$300,000 civil penalty against Jarkesy and Patriot28. The enforcement order also required Jarkesy and Patriot28 to cease and desist from further violations and to disgorge earnings, and prohibited Jarkesy from participating in the securities industry and in offerings of penny stocks. Jarkesy and Patriot28 appealed to the federal Fifth Circuit, which vacated the SEC's order.

The Decision

The Supreme Court's decision addressed the question of whether the Seventh Amendment to the United States Constitution entitles a defendant to a jury trial when the SEC seeks civil penalties for securities fraud under federal securities laws. The Court held that a defendant facing a fraud suit for civil penalties has a right under the Seventh Amendment to be tried by a jury.

The Supreme Court's 6-3 decision turned on whether the claim at issue is “legal in nature,” regardless of whether it derives from a specific statute or regulation. To determine whether a suit is “legal in nature,” the Court looked to the remedy being sought. In this case, the SEC sought civil penalties. Because the Court concluded that the civil penalties sought under the Securities Exchange Act and the Investment Advisers Act are punitive, the SEC's claim was legal in nature, entitling the defendant to a jury trial under the Seventh Amendment. In examining the federal securities laws' civil penalty provisions, the Supreme Court focused on the statutory factors relevant to the agency's decision to assess the penalties, as well as the statutory tiering scheme that determines the penalty amounts. The Court also premised its reasoning on the fact that the SEC's

causes of action under the anti-fraud provisions of the federal securities laws bore a close resemblance to common law fraud claims.

The Supreme Court denied the government’s argument that a “public rights” exception to the Seventh Amendment jury trial requirement applied in this case, rejecting the idea that Congress could assign this case to an administrative agency rather than a federal court. The key issue in determining whether the “public rights” exception applied was not whether the cause of action derives from a regulatory scheme, but rather on the substance of the action itself—in this case, fraud. Because the substance was similar to common law fraud, the Court refused to rely on the “public rights” exception. The Court distinguished precedent relied on by the SEC because in that prior case, the cause of action had originated from a regulatory regime specifically implemented to address novel (at the time) concerns: occupational safety and health. In concluding that the “public rights” exception did not apply, the Court also noted that the federal judiciary has a long history of handling fraud claims, so federal judges have the capacity needed to adjudicate such actions.

Relevant Considerations

On its face, the *Jarkesy* holding does not extend to agencies *other than* the SEC, or even actions *other than* federal securities fraud claims seeking civil penalties. But any bank, and any individual director or officer, should consider how the decision may be utilized to seek a jury trial in federal court instead of trying to defend against an administrative action by the banking agencies before an ALJ. The key questions to analyze the facts of a given case against the *Jarkesy* decision are:

- **What is the nature of the government’s claim, and can it be analogized to a common law claim?** Bank agency claims alleging fraud would certainly seem to align with the *Jarkesy* decision. Other common allegations that can be analogized to fraud claims, even if not labeled ‘fraud’, would also likely fall within the scope of the decision. In contrast, causes of action that derive from novel regulatory schemes administered by the banking agencies to address areas of modern banking business would seem to fall outside the scope of the *Jarkesy* decision.
- **What is the nature of the remedy being sought?** Bank agency actions seeking civil money penalties (“CMPs”) will align with the *Jarkesy* decision, especially because the relevant federal CMP statute used by the banking agencies, 12 U.S.C. § 1818, features tiers that increase the amount of a penalty based on the presence of certain aggravating factors, such as impact to the institution, or knowledge of the defendant. Other bank agency enforcement actions, such as prohibitions and removals, can likely easily be analogized to civil penalties because they are intended to be punitive. Cease-and-desist orders (“C&D”), on the other hand, are not as easily analogized to a punitive action because they are often structured to be remedial. However, depending on the terms and conditions of a C&D, and the effects on the recipient, courts may find this type of action punitive in nature as well.
- **How complex are the issues at stake?** Bank agency regulations that are hypertechnical or complex may better fit an argument that the expertise of a specialized ALJ is needed. The

Court noted that federal judges are familiar with fraud claims, so other common claims brought by the bank agencies—such as allegations that directors and officers breached their fiduciary duties—are more likely to fall within *Jarkesy*'s scope, as courts regularly deal with these concepts in contexts outside of banking. It will be easier for a defendant to argue such claims belong in federal court and do not require a specialized ALJ.

Practical Implications

In the near future, institutions should expect a bank—or more likely an individual director or officer—facing an enforcement action, especially a CMP, from the OCC, FDIC, FRB, or CFPB, to explicitly rely on *Jarkesy* in seeking a jury trial in federal court, rather than allow the challenge to play out in front of an ALJ. Case law from defendants challenging actions by federal agencies other than the federal bank regulators may also shape the way bank agency actions proceed. The calculus that every bank or individual defendant goes through in deciding whether to consent to a proposed bank agency enforcement action will materially change as a result of *Jarkesy*.

Practical implications from the *Jarkesy* decision on the bank agency enforcement process include the following:

- There may be statutory, regulatory, and practical limitations on the federal banking agencies pursuing cases in federal court right away, which may hold up active investigations and cases while the agencies evaluate the legal risks posed by, and effects of, the *Jarkesy* decision.
- The specific allegations made in reports of examination will likely be impacted to some degree by this decision, because if they are close to the claims in *Jarkesy*—or could be analogized to a common law cause of action—and those allegations later serve as the basis for an enforcement action, defendants may seek to push those claims to federal court.
- Defendants will have increased leverage to alter the description of the allegations in public consent orders, because defendants may threaten to challenge agency allegations that can be compared to common law claims by going to federal court.
- Because the federal banking agencies currently bring enforcement actions only in administrative court—unlike the SEC or even the CFPB, which have the option to file in federal court—the agencies' enforcement staff will not have the same expertise in federal procedure and process, or jury trial experience. Discovery procedures in federal court will give defendants' additional rights, including a greater ability to seek information from the agencies. Defendants' rights in the existing administrative enforcement process are more limited.
- Federal court proceedings will also significantly increase costs for the agencies to pursue enforcement actions. Therefore, cost will likely become a critical factor in an agency decision to pursue an enforcement action where a defendant has indicated he or she will not consent to a proposed action.

- Certain courts across the country may develop more favorable precedent on the open questions described above, making the decision of where to file (and whether appropriate jurisdiction can be established in a sympathetic jurisdiction) an important consideration.
- The body of case law that the bank agencies have developed through ALJ rulings—not all of which is publicly available to other defendants outside of the immediate case—will likely have far more limited precedential value in federal court. Without the aid of favorable precedent, the federal banking agencies will have to argue many issues for the first time in front of judges who have no familiarity with the concepts or the history behind them.
- With cases coming to federal court more, expect issues that are more or less settled in the bank regulatory world, such as the prohibition on disclosure of confidential supervisory information, or the overriding of attorney-client privilege in agency requests for documents, to come under increased judicial scrutiny. Decisions by federal courts in enforcement cases on these types of issues could impact the day-to-day relations between the regulators and banks.

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Luse Gorman regularly advises banks and their individual directors and officers in investigations and enforcement actions initiated by federal and state banking agencies and the CFPB. If you have any questions related to this Client Alert, please reach out to Brendan Clegg, Partner, at (202) 274-2034 or by email at bclegg@luselaw.com. To learn more [about our firm](#) and [services](#), [please visit our website](#).

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