

Fifth Circuit Requires Jury Trials for SEC Fraud Defendants

By **Rachel Maimin** and **Robert A. Johnston Jr.**

On May 18, the U.S. Court of Appeals for the Fifth Circuit held that defendants in SEC enforcement actions for fraud are entitled to jury trials in federal court rather than simply appearing before an SEC administrative law judge (ALJ). *Jarkesy v. United States*, No. 20-610007 (5th Cir. May 18, 2022). Several constitutional bases underlie the court's decision, but the bottom line is that this decision may have significant national impact on the SEC's ability to avoid jury trials. Though the Fifth Circuit only covers Texas, Louisiana, and Mississippi, the United States Supreme Court may agree with the Fifth Circuit on appeal or other jurisdictions may follow this holding in the slew of challenges that will inevitably follow *Jarkesy*. In any event, all defendants with civil fraud cases presently before, or expected to be before, an SEC ALJ—or with the holding of such an ALJ on appeal, for that matter—now have a powerful argument that the Constitution entitles them to a jury trial.

Jarkesy was a standard securities fraud case alleging various misrepresentations on the part of the defendants. The SEC chose to bring a fraud action against the defendants before an ALJ within the SEC—seeking both financial penalties and injunctive relief—rather than filing in federal court, pursuant to powers expressly granted to the SEC by Congress. The defendants argued they were entitled instead to a jury trial in federal court. The argument was rejected by the SEC. The Fifth Circuit vacated that decision on several grounds, including, in particular, that proceeding before an ALJ deprived the defendants of their Seventh Amendment right to a jury trial in cases like *Jarkesy*, where the enforcement action is essentially the same as any traditional fraud case. The key question is whether the proceeding centers on so-called public rights, which are “so closely integrated with a comprehensive regulatory scheme that

the right is appropriate for agency resolution.” See *Jarkesy* at 8. A run-of-the-mill securities fraud case seeking financial penalties, the *Jarkesy* court held, does not meet this standard.

This is a major blow to the SEC's power to, in essence, adjudicate its own cases when it chooses. Jury trials are intended to be, and are, checks on government power. It is difficult to imagine a situation where a securities fraud defendant would prefer an SEC ALJ over a jury. Any civil securities fraud defendant currently charged, or expecting to be charged, by the SEC should consider demanding a jury trial under the reasoning of the Fifth Circuit, no matter the jurisdiction. Nothing is guaranteed, but a jury trial is almost certainly a better bet.

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