SEC and FINRA face new limits on enforcement powers in post-Chevron landscape

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JULY 25, 2024

Two recent decisions handed down by the Supreme Court may serve to weaken the enforcement power of federal agencies and entities in the securities industry. The decisions in the cases of *SEC v. Jarkesy* and *Loper Bright Enterprises v. Raimondo* (which overturned the precedential 1984 case *Chevron v. Natural Resources Defense Council*) stand to impact multiple federal and state regulatory agencies and entities across sectors, including the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA).

On June 28, 2024, the Supreme Court issued its decision (https://bit.ly/3XVhnqt) in *Loper Bright Enterprises v. Raimondo*, a dispute originally between the National Marine Fisheries Service and several family fishery businesses over an ambiguity in a federal fishery conservation and management act. However, the heart of the issue really rested on a case that was decided 40 years prior — *Chevron v. Natural Resources Defense Council*. This 1984 case gave birth to the precedential "Chevron deference," a doctrine that, in certain circumstances, allowed for judicial deference to federal agencies when interpreting an ambiguous or silent statute.

In the *Loper Bright* ruling, the Supreme Court overturned *Chevron*, reversing a doctrine that has been used for four decades to place broad enforcement power in the hands of federal agencies. By now shifting much of this power to the courts, the Supreme Court's decision has created a wider opening for litigants to challenge agencies' interpretations of certain rules, especially when it comes to the extensiveness or narrowness of the definition of terms within statutes. Such a tipping of the scales will likely shake up the rulemaking and enforcement powers of various federal agencies.

Regarding how the overturning of *Chevron* will affect the consistency of statutory interpretations, it depends on whether one looks at consistency over time versus consistency across courts. While the *Chevron* deference doctrine created national consistency by placing power with a handful of federal agencies with expertise on certain subject matters, many federal agencies do change stances relative to what political party is currently in office.

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A separate but related decision (https://bit.ly/468ocXz) issued by the Supreme Court was handed down in *SEC v. Jarkesy* on June 27, 2024. The Jarkesy suit was brought by George Jarkesy, a hedge fund manager found culpable of committing securities fraud after the SEC commenced enforcement proceedings against him in 2013.

Historically, when the SEC decides to file a civil suit against a defendant, it can either do so in federal district court or choose to adjudicate the issue via administrative proceedings in its own internal tribunal system consisting of administrative law judges (ALJs). The SEC chose to pursue the latter option with Jarkesy.

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After Jarkesy was convicted by one of the SEC's in-house judges, he subsequently sued the SEC, challenging the constitutionality of the Commission's in-house judicial system, claiming it violated his Seventh Amendment right to a trial by jury in "suits at common law."

The suit essentially argued that a civil enforcement action where the SEC seeks monetary penalties for securities fraud is akin to a case of "common law fraud," and a defendant therefore has the right to a trial in federal court rather than before an SEC in-house judge. Jarkesy petitioned for review from the 5th U.S. Circuit Court of Appeals, which found in favor of Jarkesy and deemed the SEC's use of its in-house judiciary unconstitutional, with the Supreme Court upholding the 5th Circuit's ruling.

This decision also overturned many years of precedent and affects not only the SEC but could have ramifications for other federal and state regulatory agencies that impose civil penalties through administrative proceedings and their respective in-house enforcement apparatuses.

In a dissenting opinion, Justice Sonia Sotomayor pointed out that Congress has enacted over 200 statutes "authorizing dozens of agencies to impose civil penalties for violations of statutory obligations" based on the Court's precedent that federal agencies were allowed to adjudicate certain issues in-house.

However, the SEC had already largely shifted away from administrative proceedings beginning in 2018, when there were other legal challenges aimed towards its ALJs. Because of this, many of the SEC's fraud actions seeking monetary penalties have been litigated in federal district court for the past few years, meaning that this ruling will have less of an impact than it might have otherwise on the SEC.

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But this is not to say that other agencies in the financial regulation industry won't be affected. FINRA, for example, has no private right of action under the federal securities laws and therefore can only try cases involving federal securities fraud within its own tribunal system. However, FINRA penalties, such as monetary damages and licensing revocations, similar to those imposed upon Jarkesy, implicate some of the same factors the Supreme Court considered in its decision. It is likely that courts would determine that FINRA-registered representatives have that same Seventh Amendment jury trial requirement. FINRA would therefore theoretically lose its ability to bring federal securities enforcement proceedings at all — it would likely have to refer such cases to the SEC.

We are already seeing the first challenges to FINRA's authority in this context. In a motion filed on July 10, 2024, Allen Blankenship — a registered representative — petitioned the Eastern District of Pennsylvania to enjoin FINRA from proceeding with an in-house administrative hearing against him in light of the *Jarkesy* ruling.

The complaint argues that Blankenship, who has been accused of misrepresentations and omissions fraud by FINRA, has a right to a Seventh Amendment jury trial under the criteria laid out in the *Jarkesy* decision. Blankenship is therefore seeking a preliminary injunction to halt FINRA's in-house adjudication and avoid an "imminent violation of [his] constitutional rights." (*Blankenship v. FINRA*; Civil Action No. 2:24-cv-3003).

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In the securities industry, the SEC might see an uptick in litigation as defendants feel emboldened to challenge what they feel are overreaching interpretations or unconstitutional proceedings. On the other hand, the SEC may attempt to be more selective in the enforcement actions it chooses to litigate.

Federal agencies still have many tools available to them for enacting rule enforcement. With the loss of both the *Chevron* doctrine and in-house adjudication systems, however, these authorities are going to have to dig a little deeper into their respective toolboxes.

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This article was first published on Reuters Legal News and Westlaw Today on July 25, 2024.