



Fifth Circuit Holds That SEC Administrative Law Courts Are Unconstitutional

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The most recent salvo in the long-running dispute about the constitutionality of the Securities and Exchange Commission's (SEC) administrative law courts was launched May 18 in a U.S. Court of Appeals for the Fifth Circuit decision, [Jarkesy v. SEC](#), and it's a bracing read. Unlike prior decisions on the subject, which contented themselves with chipping away at the edges of the SEC's administrative authority, the Fifth Circuit didn't pull punches. It held that the SEC's in-house courts violate a trifecta of constitutional protections: the Seventh Amendment's right to a jury trial, the prohibition in Article I on excessive delegation of Congress' "legislative power," and the restrictions in the "Take Care" clause of Article II as applied to the removal of SEC administrative law judges (ALJs).

Jarkesy started out as a run-of-the-mill fraud case against the founder of two hedge funds related to misstatements about the funds' investment parameters and assets, among other information. The SEC filed the case in its in-house administrative court, and Jarkesy sued in the U.S. District Court for the District of Columbia to enjoin the SEC action because, he said, it violated his constitutional rights. The District Court and, later, the D.C. Circuit Court both rejected the request for an injunction. After Jarkesy lost in the

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SEC administrative proceeding and on appeal to the full SEC, he appealed to the Fifth Circuit.

On the Seventh Amendment issue, the Fifth Circuit acknowledged that Congress may constitutionally bypass the right to a jury trial in cases where “public rights” are being litigated. Contrary to decades’ worth of case law, though, the court decided that SEC fraud actions that seek civil monetary penalties aren’t intended to vindicate public rights after all, but are more like traditional common law cases to which the constitutional right to a jury trial attaches.

The dispute in *Jarkesy* about excessive Congressional delegation under Article I had to do with the SEC’s discretion to decide whether to file its suits in federal district court, which the SEC is authorized to do by statute, or instead to bring suit in the agency’s in-house administrative forum. On this point, the Fifth Circuit reasoned that the delegation of discretion was unconstitutional because the authority to assign disputes to federal agency adjudication is “peculiarly within the power of the legislative department,” and that Congress failed to prescribe a “guiding intelligible principle” about how the SEC should determine which forum to file its cases in, as U.S. Supreme Court case law requires.

The Fifth Circuit also decided that ALJ appointments violate the requirement of Article II of the Constitution that the president “take Care that the Laws be faithfully executed.” In the court’s view, because ALJs “exercise considerable power over” SEC administrative proceedings, they should be readily subject to removal by the president to ensure that the laws of the United States are faithfully executed. According to the court, because “ALJs are sufficiently insulated from removal . . . the President cannot take care that the laws are faithfully executed” in violation of Article II.

As the Fifth Circuit mentioned in its *Jarkesy* opinion, the constitutionality of the SEC’s administrative law courts was the subject of the Supreme Court’s recent decision in *Lucia v. SEC*, and while the Supreme Court did find some constitutional shortcomings in the way ALJs are appointed, that decision was fairly limited in scope. Maybe the sweeping constitutional problems the Fifth Circuit discovered last week weren’t properly presented in the *Lucia* appeal, and so weren’t considered, but it seems unlikely that the Supreme Court would have ignored such momentous violations if it had seen them. Which doesn’t augur well for the Fifth Circuit’s *Jarkesy* decision when it goes up on appeal, which it will.

Also ominous is the fact that the D.C. district and appellate courts disagreed with Jarkesy’s reading of the Constitution, since those courts are widely regarded by securities lawyers to be authorities on the arcana of U.S. administrative law. If the Supreme Court shares that view of the D.C. courts’ expertise—and past Supreme Court decisions suggest that it often does—it seems probable that Jarkesy’s victory will be short-lived.