

Recent Supreme Court Decisions Signal Increased Investor Litigation

U.S. law has historically offered investors two primary avenues for protecting their interests: (i) through enforcement by U.S. regulatory agencies, like the Securities and Exchange Commission (“SEC”), and (ii) through private investor litigation. In addition to safeguarding investor interests, these avenues also serve to regulate U.S. financial markets, serving as a deterrent against securities fraud.

However, two recent Supreme Court decisions significantly curtailed U.S. agency power, thereby limiting the SEC’s ability to protect investors interests (and regulate financial markets). These decisions effectively shift power from the SEC and their administrative courts – where many of these issues have been historically resolved – to be resolved in the U.S. court system instead. Investors’ will face new obstacles in attempting to advance their interests through U.S. regulatory agencies, leaving them with effectively one option: litigation.

On June 27, 2024, the Supreme Court issued a decision in *SEC v. Jarkesy*.¹ This case concerned a civil administrative action for violations of federal securities laws brought by the SEC against George Jarkesy and investment firm, Patriot 28,

LLC.² An administrative law judge overseeing the matter found the defendants liable for \$300,000 in civil penalties.³ The defendants sought review of the findings and civil penalties in the U.S. Court of Appeals for the Fifth Circuit.⁴ Ultimately, the Fifth Circuit Court reversed and remanded the action on the grounds that the SEC’s findings violated the Seventh Amendment of the U.S. Constitution.⁵ Specifically, the Appellate Court found that the SEC’s administrative hearing and determination violated the defendants’ right to a jury trial.⁶ The Supreme Court agreed – holding that, under the Seventh Amendment, defendants are entitled to a trial by jury (in federal court) where the SEC seeks civil penalties for securities fraud.⁷

As a practical matter, *Jarkesy* narrows the SEC’s power to maintain civil administrative actions for securities fraud. Indeed, the SEC is now required to bring any action that may involve civil penalties in federal court. The Supreme Court’s curtailment of the SEC’s authority has also resulted in many questions about the SEC’s future approach to enforcement actions – namely, whether the SEC be more selective in its future enforcement efforts.

¹ *SEC v. Jarkesy*, 603 U.S., at 2 (2024) (No. 22-859).

² *Id.*

³ *Id.*

⁴ *Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022).

⁵ *Id.*

⁶ *Id.*

⁷ *SEC v. Jarkesy*, 603 U.S., at 2 (2024) (No. 22-859).

In keeping with its examination of agency power, the Supreme Court issued a decision in *Loper Bright Enterprises v. Raimondo* on June 28, 2024.⁸ This decision overturned the longstanding doctrine established by *Chevron USA v. National Resources Defense Council* by holding that courts may now rely on their own interpretations of ambiguous laws, without deference to applicable federal agencies, like the SEC.⁹ In the majority opinion, Chief Justice Roberts explained that the *Chevron* doctrine (which called for judicial deference to agency rulemaking) was not compatible with the court's duty to "say what the law is."¹⁰ *Loper* upends the previous balance of power between administrative agencies and federal courts, narrowing (and possibly eliminating) agencies' ability to interpret and implement federal law. While the full effect of this decision remains to be seen, many suspect that agencies, like the SEC, will issue fewer regulations. Moreover, in instances where agencies do promulgate administrative law, there will be a greater risk of inconsistency as courts across the country issue varying interpretations of the regulations.

The Supreme Court's decisions to reduce agency power directly impact the SEC, one of the central administrative agencies in the U.S. Notably, the decisions do not constitute a complete elimination of the powers previously afforded to the SEC. Instead, the Supreme Court has shifted the power back to the hands of Article III judges –

a clear signal that issues, like securities fraud issues, should be litigated in court.

Indeed, in the wake of these decisions, investors must reevaluate their options for protecting shareholder value. With the SEC constrained by the Supreme Court's holdings and limited resources, solely protecting shareholder interests in connection with the SEC may not be enough. Fortunately, market participants have strong (and potentially expanded) opportunities to exercise their rights in federal court. For example, investors may now seek clarification of statutory interpretations related to their fraud actions in court without having to expend additional time and resources waiting for guidance from the SEC. Additionally, market participants have the opportunity to redress financial fraud through the U.S. class action framework. Securities fraud actions are uniquely poised for class treatment under federal law, allowing investors to bring class actions that redress corporate wrongdoing and promote positive change on a widespread basis. While these Supreme Court decisions have been seen as pro-business – in that they decrease the SEC's power to regulate – these decisions could have a negative effect on publicly traded companies. Big business should anticipate a marked increase in private securities litigation.

As investors look ahead, protecting their rights through litigation will become increasingly important. President-elect Trump's has already indicated that he will make drastic changes to the SEC, including by publicizing plans to fire SEC

⁸ *Loper Bright Enterprises v. Raimondo*, No. 22–451, 603 U.S. (2024).

⁹ See *id.*; *Chevron USA v. National Resources Defense Council*, 467 U.S. 837 (1984).

¹⁰ *Loper*, slip op. at 7.



Chair Gary Gensler.¹¹ This and other anticipated political changes will continue to slow the SEC's already declining in-house efforts, further increasing the need for and likelihood of investor litigation to protect shareholder¹² rights under the federal securities laws.

Labaton Keller Sucharow's lawyers are available to address any questions you may have regarding these developments. Please contact the Labaton Keller Sucharow lawyer with whom you usually work or the contacts below.



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¹¹ Trump Pledges to Fire Gensler, Hire People Who 'Love' Crypto, *Bloomberg Law*.

¹² Bloomberg Law's SEC ALJ Analytics Tracker, July 30, 2024–July 29, 2024.