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Report

RegTech Report

U.S. Supreme Court Checks Regulator Power

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Jarkesy: Regulators' in-house courts curtailed

Decision

On June 27th, in SEC v. Jarkesy et al., the Court ended the SEC's use of in-house courts for resolving antifraud actions that result in punitive fines. In a 6-3 decision along the familiar ideological line, the Court held that because the U.S. Constitution's 7th Amendment guarantees the right of a jury trial for common law civil suits, the SEC instead must bring such charges before a jury in federal court.

Scope

Much of the Court's Opinion focused on actions based on "public rights", which the Court acknowledged are not grounded in "common law" and therefore can be resolved in juryless proceedings of federal agencies. These include matters like collection of revenue for the Treasury, immigration policy, tariffs, Indian tribe relations, federal lands and public benefits. But SEC actions for fraud in violation of securities laws, such as an advisor lying to investors, address "private rights" grounded in common law and therefore require a jury, according to the Court.

This would include SEC actions relying on the securities fraud statutes, for statements made by investment advisors and others, found in Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Section 206 of the Investment Advisers Act. And it could encompass many more types of actions, brought by the SEC or other government agencies, as determined in the future by courts entertaining new sets of facts and tasked with deciding what qualifies as a "common law" claim requiring a jury.

What to expect

In recent years, in light of anticipated constitutional challenges, the SEC had already reduced its use of administrative proceedings for imposing fines. But with the Jarkesy decision, that avenue is now formally closed. The SEC therefore can be expected to continue looking to federal courts, and perhaps even more so now, to resolve such civil claims. And yet, because litigation can be costly, the SEC alternatively may choose to craft more narrowly tailored allegations, or seek remedies other than punitive fines, so as to avoid triggering a jury requirement in the first place.

Jarkesy also means that firms facing enforcement actions could see an increased willingness to negotiate on the part of the SEC, the CFTC and other affected agencies. Such firms will, of course, need to balance that consideration with the possibility of federal litigation before a jury, with the potential costs and benefits that would bring. As stated above, further court rulings (and any guidance issued by agencies themselves) will be needed, to see more precisely where the line falls between an administrative proceeding and the right to a jury trial.

"[T]he civil penalties in this case are designed to punish and deter, not to compensate. They are therefore 'a type of remedy at common law that could only be enforced in courts of law.' That conclusion effectively decides that this suit implicates the Seventh Amendment right, and that a defendant would be entitled to a jury on these claims."

Chief Justice John Roberts, U.S. Supreme Court, Majority Opinion, SEC v. George R. Jarkesy, Jr., et al. (27 June 2024)

Loper: End of default judicial deference to regulators

Decision

On June 28th, in considering jointly the two cases [Loper Bright Enterprises et al. v. Secretary of Commerce et al. and Relentless, Inc. et al. v. Department of Commerce et al.], the Supreme Court overturned the "Chevron deference" paid to regulators. The Chevron doctrine has required that federal courts, for the purpose of deciding whether an agency has exceeded its authority deriving from laws passed by Congress, defer to the regulator's interpretation of such laws when they are ambiguous (as long as that agency interpretation is "reasonable"). Like in Jarkesy (see above), in Loper the Court voted 6-3 along its commonly seen ideological line.

Decision

The Supreme Court's rejection of Chevron deference (launched in 1984 with the case Chevron v. Natural Resources Defense Council) means that a federal court is no longer required to simply defer to an agency's reasonable interpretation of what an ambiguous law says, in determining what the agency is or is not authorized to do. Instead the court should exercise its independent judgment (as long as consistent with the Administrative Procedures Act, which in 1946 set forth the procedures for agency actions and their judicial review).

Of course, courts will still be free to agree with an agency's interpretation of an ambiguous law. In fact the Supreme Court acknowledged that, especially in technical matters, it can be appropriate for courts to consider an agency's experience and informed viewpoint. The Court also allowed that, where a law expressly delegates discretionary authority to an agency, courts should continue to recognize that delegation as they have in the past.

As for prior court decisions relying on Chevron deference, the Supreme Court in Loper affirmed that those rulings stand, and hence those relevant prior actions by regulators are still considered lawful. But the Court did not rule out the possibility of those once-challenged regulations being subject to more lawsuits.

What to expect

The Court had sharp words for the Chevron doctrine, calling it a "crumbling precedent". It pointed out that already, it had placed limits on Chevron deference throughout the doctrine's history, that it hadn't even applied the concept to a case since 2016, and that some federal courts had already chosen to ignore or gloss over the doctrine in their rulings. (Separately, it's worth noting that at the state level, Chevron-like deference to state regulators has been reduced within the last decade, through various states' legislative, constitutional and judicial measures.)

And yet the Court's final nail-in-the-coffin for Chevron is likely to have broad and significant implications. From now on, every federal court that is wary of a particular regulation, brought before it by anyone challenging the agency's rules under an insufficiently specific law, will no longer be obliged to give the agency the benefit of the doubt. This new approach is set to affect not just the particular agency involved in the Loper case (the National Marine Fisheries Service), but massive rulemaking bureaucracies from the SEC to the Department of Labor to many others.

For these agencies, the Court's decision in Loper means their rulemaking likely will narrow in scope, attempting to fit more closely within the relevant law set forth by Congress (however vague). And for Congress itself, the decision should encourage the use of more precise statutory language, including wherever Congress decides to delegate discretion to regulators.

For financial firms and industry trade bodies, Loper could mean that some will now fancy their chances at legal challenges, brought before judges now empowered to scrutinize regulations more independently.

As with the Jarksey decision, fallout from Loper will be measured by how federal courts rule based on the new precedent it establishes. (In fact Loper should impact many more cases than Jarkesy, across more industries and agencies, as it strikes at the heart of executive agency power.)

There are 94 federal District Courts and 13 Circuit Courts of Appeal, employing about 850 different judges, authorized to hear challenges to federal rulemaking (depending on procedural rules about proper venue). Loper now gives each of those federal judges more independence, and so it's impossible to predict the ruling's specific impacts down the road. But an early test case could be the 5th Circuit's consideration of a challenge to the Department of Labor's "tiebreaker rule" that permits ERISA plan fiduciaries to consider ESG factors. On July 9th, during oral arguments, the 3-judge panel suggested that it could send the matter back to District Court because that court had earlier relied on the now-overturned Chevron case.

But in trying to predict the future with respect to Loper, at the moment the only certainty is uncertainty, as agency rulemaking is now more vulnerable. Moreover in the near term, and more consequential than Loper for regulatory policy, is the election in November which could heavily impact both the regulatory and lawmaking branches of government (as we detailed in our March edition). Across industries, this should suggest a 'wait and see' approach for most. Certain others, feeling aggrieved by a regulation, will smell blood in the water from Loper and decide that now is the time to mount a challenge in court.

"Perhaps most fundamentally, Chevron's presumption is misguided because agencies have no special competence in resolving statutory ambiguities. Courts do."

> *Cheif Justice John Roberts, U.S. Supreme Court, Majority Opinion, Loper Bright Enterprises et al. v. Secretary of Commerce et al. and Relentless, Inc. et al. v. Department of Commerce et al. (28 June 2024)*

Corner Post: Extension of time limits when challenging regulations

Decision

After its decisions in Jarkesy and Loper on July 27th and 28th, the Supreme Court wasted no time in dealing yet another blow to federal administrative power. On its next working day of July 1st, in Corner Post, Inc. v. Board of Governors of the Federal Reserve System, it held that when a party claiming injury from a regulation sues the regulator under the Administrative Procedures Act (APA), that party's deadline period for filing its lawsuit doesn't start until its injury occurs.

In other words, for the federal law requiring that lawsuits challenging regulations under the APA be filed "within 6 years" (i.e. a 6-year "statute of limitations"), that now means within 6 years after the plaintiff is affected by the regulation, and not merely 6 years after that regulation was enacted.

As in Jarkesy and Loper, the Justices in Corner Post voted 6 to 3 along that familiar ideological line.

Scope

In the Corner Post case, the Federal Reserve Board in 2011 had set a specific limit on what debit card networks like Visa and MasterCard could charge merchants for transaction fees (pursuant to a federal statute requiring that such fees be "reasonable and proportional"). Several years later in 2018, a truck stop called Corner Post opened for business in North Dakota, accepting debit cards as payment and paying the transaction fees. In 2021 the store joined an existing lawsuit by a retail group, against the Federal Reserve Board, claiming that its 2011 regulation had set the transaction fee limit too high (in violation of the federal statute). A federal court dismissed the lawsuit for being too late, holding that the 6-year statute of limitations for filing suits against the government put the filing deadline in 2017. The 8th Circuit Court of Appeals affirmed.

The Supreme Court disagreed, stating that because Corner Post was not injured by the card transaction fees until 2018 when it opened for business, its 6-year deadline clock for suing the regulator started only then. Therefore by 2021 when the store sued, its filing deadline period had not yet expired, and hence the lawsuit could proceed.

The Corner Post decision will open the door for more lawsuits not just against the Federal Reserve, but against many other agencies like the SEC whose regulations can be challenged under the APA. The relevant 6-year statute of limitations, 28 U.S.C. §2401(a), applies as a default rule for "every civil action commenced against United States". (Exceptions are provided for some agencies like the FCC, DOT and Agriculture, as mentioned in this excellent analysis of the decision).

The Court signaled that generally in a statute of limitations, a key piece of text describes the deadline period as starting "when the right of action first accrues". This is the phrasing used in §2401, and should be interpreted to mean when the plaintiff is injured, said the Court.

By contrast, the Court observed, other statutes may expressly describe a lawsuit deadline period as starting upon "the issuance of any regulation" or with similar language. The Court categorizes such laws not as statutes of limitations, but as "statutes of repose". That textual difference will be important, for anyone deciding to challenge a regulation years after it first appears.

What to expect

The 6-year time limit in § 2401, which Corner Post now says doesn't begin to run until a plaintiff's injury, is seen as the default rule for suits against any government agency. As such, the Court's decision creates the possibility of a great many new lawsuits.

This is especially true in light of the Court's Loper decision (that ended judges' "Chevron deference" paid to regulators). As one legal and business expert puts it, according to this insightful article on Corner Post and Loper's combined impact:

"It won't take long for CEOs to figure out that five or more years of uncertainty about the validity of anything the SEC, FTC, FCC, CFPB, OCC, EPA, NLRB, HHS or any other agency does makes corporate strategic and investment decisions incredibly challenging."

At the same time, keep in mind that Congress can always decide to step in and modify §2401, by expressly providing that the lawsuit deadline period starts upon issuance of the pertinent regulation. (A fact which was important to the Court's reasoning in Corner Post. If Congress had intended to take that approach when it drafted §2401, said the Court, Congress would have included that key language.)

"The dissent . . . warns that today's opinion will 'devastate the functioning of the Federal Government'. This claim is baffling – indeed, bizarre – in a case about a statute of limitations. . . . We have more confidence in both the Executive Branch and the Judiciary."

> *Associate Justice Amy Coney Barrett, U.S. Supreme Court, Majority Opinion, Corner Post, Inc. v. Board of Governors of the Federal Reserve System (1 July 2024)*

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