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A Powerful New Challenge to Administrative and Exchange Enforcement Actions

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CFTC Commissioners recently recognized that the Supreme Court's decision in *SEC v. Jarkesy* provides respondents with a [powerful new tool](#) to challenge administrative and exchange enforcement actions. Thus far, self-regulatory organizations, including futures exchanges, have been less directly in the line of fire. But we predict that SROs could face aggressive challenges in the wake of *Jarkesy*. Its reach may extend beyond the SEC and other federal agencies to reach the NFA and even exchanges like CME and ICE that use administrative proceedings to police market participants.

SEC v. Jarkesy

In *Jarkesy*, the Supreme Court held that the Seventh Amendment entitles defendants accused of securities fraud the right to a jury trial. The Court reasoned that the Seventh Amendment applies to claims created by federal statute if they are "legal in nature," as opposed to claims that seek equitable relief.

Whether a claim is "legal in nature" depends on the cause of action and the relief sought. Under the Court's two-part analysis, a securities fraud action is legal in nature because (1) it is so closely aligned to common law fraud, and more importantly, (2) the SEC seeks civil penalties that are "designed to punish and deter, not compensate." The Court found the second factor "all but dispositive" because "civil penalties are a type of remedy at common law that could only be enforced in courts of law."

Calling Administrative Proceedings Into Question

In the post-*Jarkesy* world, regulators' use of administrative proceedings is under heightened scrutiny. Apparently undeterred, the CFTC recently filed four administrative complaints for enforcement actions before a CFTC temporary hearing officer. But Commissioners Pham and Mersinger both dissented, citing the *Jarkesy* ruling. Commissioner Pham's dissent was particularly scathing, deeming it "unbelievable" that even in the wake of *Jarkesy*, the CFTC is "doubling down on bringing enforcement actions before a hearing officer – not even an Administrative Law Judge."

While the majority of the Commission found no issue with the use of a temporary hearing officer, the dissents will provide fodder for defendants who want to mount challenges to CFTC enforcement matters.

Alpine Securities v. FINRA

Applying the reasoning from *Jarkesy* to challenge SROs poses additional hurdles because SROs are private actors, which makes a constitutional challenge to their enforcement procedures more difficult.

But challenges to SROs have already begun. In *Alpine Securities v. FINRA*, Alpine raised several constitutional challenges to FINRA's attempt to expel them through an internal, expedited hearing process.

In *Alpine Securities*, FINRA seeks an all-out expulsion, which has significant financial ramifications and is also meant to punish the wrongdoer rather than make the alleged victim whole. Last year, the D.C. Circuit Court of Appeals enjoined FINRA from moving forward with its hearing process, finding that Alpine was likely to win its argument that FINRA hearing officers exercise impermissible executive authority. A win for Alpine would represent an extension of *Jarkesy's* reasoning to an SRO, which could be extended in subsequent decisions.

Using *Jarkesy* to Challenge SROs

The Court's reasoning in *Jarkesy* also strengthened the arguments of market participants facing discipline by exchanges. A win for Alpine would also be helpful because it would demonstrate that the reasoning of *Jarkesy* applies to SROs. Respondents can argue, as Alpine has against FINRA, that exchanges exercise impermissible executive authority when they seek monetary penalties, suspensions, or expulsions for rule violations.

These challenges face additional hurdles that were not present in *Jarkesy* or *Alpine Securities*. First, those who trade on exchanges have often contractually agreed to be subject to the rules of the exchanges and their disciplinary framework. Second, the types of rules that exchanges enforce lack common law analogues, making *Jarkesy's* reasoning less applicable. It is difficult to analogize spoofing or wash trading to a common law claim.

These challenges will need to be overcome, but courts seem increasingly willing to question the authority of regulators who bring enforcement actions with significant financial consequences through in-house tribunals instead of federal courts. Market participants facing enforcement actions can now add *Jarkesy*, and potentially *Alpine Securities*, to their increasingly powerful defense toolkit.

*This article has been updated since its original publication in the [NIBA Newsletter](#).



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