Sick of ALJs? The New Right to Federal Court During Agency Prosecutions

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Authors:

J. Austin Hatfield

Practitioners and scholars all agree that last summer, the U.S. Supreme Court overhauled the administrative state. And no, not simply by overturning *Chevron*, which was undoubtably the most significant decision of the Supreme Court's 2023-24 term. Rather, in addition to the Supreme Court's decision to overrule *Chevron* in *Loper Bright Enterprises v. Raimondo*[1] (and the expansion of the six-year limitations period for administrative challenges in *Corner Post Inc. v. Board of Governors*[2]), the Supreme Court last summer decided *SEC v. Jarkesy*,[3] holding that administrative penalties must be enforced in federal courts rather than administrative tribunals.

In *Jarkesy*, the U.S. Securities and Exchange Commission (SEC) imposed a fine against Jarkesy for violating the agency's anti-fraud regulations. An administrative law judge (ALJ) had adjudicated the fine, and the SEC affirmed. Jarkesy appealed under the Securities Exchange Act to the Fifth Circuit and eventually the Supreme Court, arguing that the SEC's original prosecution was subject to the Seventh Amendment, which entitled Jarkesy to defend himself before a jury. The Supreme Court agreed. It held that the SEC's anti-fraud regulations were intended to govern the same basic conduct as common-law fraud and that the penalties imposed "legal" relief as punishment for Jarkesy's wrongdoing. And because the Seventh Amendment entitles litigants to a jury trial for any claims that are "legal in nature"[4]— common law or statutory—the Supreme Court held that the SEC was required to prosecute Jarkesy in federal court, rather than before an ALJ.

The Seventh Amendment holding in *Jarkesy* will have ripple effects throughout other areas of administrative law, some of which are difficult to predict this early. But at the outset, regulated parties should be aware of three basic changes going forward.

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The first is the impact of starting out in federal court. The second is the risk of parallel prosecutions for the same conduct. And the third is the role courts will play in providing regulatory guidance.

1. Starting Out in Federal Court

Initially, the obvious result of *Jarkesy* is the expanded access to federal courts for all federally regulated parties. Several federal agencies impose fines like the SEC's,[5] and after *Jarkesy*, many of those prosecutions likely will be initiated in federal court. Although *Jarkesy* only addressed the SEC, the Supreme Court determined that the punitive purpose behind the SEC's fine all but decided the Seventh Amendment's application.[6] Taking *Jarkesy* to its logical conclusion, *any* civil penalty sought by *any* federal agency, regardless of its connection to a common-law claim like fraud, is at least susceptible to a *Jarkesy* challenge.

Originally, in the world of federal agency prosecutions, the role of a federal court was as a court of *review*, rather than *first* view. Under the Administrative Procedure Act and several organic statutes, federal district courts and circuit courts can only review final agency decisions. And parties often had to simply accept an agency's initial decision due to the cost of exhausting mandatory appeals throughout the agency hierarchy. Now, under *Jarkesy*, regulated parties can start in the forum where many had hoped to end up—federal court—all without spending an extra dime. And instead of ruling on legal and factual errors after the fact, district courts can decide disputes early on through motion practice, potentially avoiding trial all together.

The practical result of receiving early judicial involvement cuts in both directions for regulated parties as well as agencies.

For some regulated parties, this new forum is encouraging news. The rules of procedure and evidence governing federal courts are generally considered to be more generous than the pro forma and often discretionary rules governing administrative tribunals. With the addition of these rules, courts will provide a more meaningful opportunity for parties to litigate their administrative liability. On the other hand, federal courts may introduce unwanted juror

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scrutiny and lengthy litigation-related delays, decreasing the financial benefits of a quick administrative hearing and increasing pressure to settle prosecutions early on.

On the agency side, to avoid creating negative judicial precedents, some officials may bring federal prosecutions only against those parties who are clearly liable for monetary fines, which would in turn lead to more predictable enforcement decisions. On the other hand, some officials may decide to bring questionable prosecutions in more favorable courts and circuits, which could result in overinclusive and underinclusive enforcement priorities throughout the country.

Where possible, some agencies may also seek to maintain access to administrative tribunals, regardless of *Jarkesy*, by extracting a jury-trial waiver as a condition for an agency benefit or license. And for parties governed by self-regulatory organizations, like the Financial Industry Regulatory Authority (FINRA), agency jury-trial waivers also may be accompanied by arbitration agreements. Regulated parties that wish to litigate in federal court would then be required to challenge those waivers under a host of enforceability-related doctrines, including under the United States Constitution and potentially the Federal Arbitration Act.

2. Multiple Prosecutions

Many agency prosecutions seek not only legal relief subject to the Seventh Amendment—civil penalties, punitive fines, etc.—but also equitable relief outside the scope of the Seventh Amendment—disgorgement, suspension, etc. Indeed, the SEC in *Jarkesy* sought both types of remedies.[7] After *Jarkesy*, these so-called "mixed" prosecutions raise several questions about facing multiple prosecutions for the same conduct.

On the administrative side, agencies will need to decide whether to seek equitable remedies alongside civil penalties in federal court or whether to bring parallel or consecutive prosecutions for each type of relief. Agencies derive significant benefits from enforcing their rules through in-house tribunals, including swift adjudications, favorable success rates, and adjudicator subject-matter expertise.

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However, the prospect of split prosecutions significantly decreases those benefits by introducing federal judges into the equation. Most importantly, when making the decision about where to bring a prosecution and what remedies to seek, agencies will need to consider the preclusive effect of an unfavorable decision rendered first in either forum, as well the impact of inconsistent judgments across both forums.

Regulated parties, on the other hand, will need to decide whether to raise a *Jarkesy* objection at the start of an administrative adjudication or at the end. One question left open after *Jarkesy* is whether the Seventh Amendment requires an agency to initiate a fine-based prosecution in federal court, or whether the Seventh Amendment only bars an agency from enforcing a fine that was originally adjudicated without a jury trial. Until that question is answered, some agencies will likely continue prosecuting regulated parties in front of administrative tribunals to see whether the adjudication actually results in a fine, as opposed to only equitable relief. Where the adjudication does not result in a fine, the agency can then file a lawsuit to seek the fine in federal court and potentially rely on the preclusive effect of the tribunal's fact finding. Where the adjudication does result in a fine, the agency may sit back to see whether the losing party simply accepts the administrative order or incurs the cost of appealing it under the Seventh Amendment—either of which results in the same increased defense costs and delays that existed for regulated parties before *Jarkesy*.

Where an agency commences a prosecution outside of federal court, a regulated party's only alternative option is to file a pre-enforcement challenge in federal court, requesting that the court enjoin the administrative prosecution. These challenges likely will turn on, in part, whether the plaintiff can show irreparable harm from having to participate in the tribunal, which may require showing separate harm imposed by the agency, like a provisional suspension pending adjudication or imminent loss of customer goodwill. When making this decision, a regulated party will also need to consider the preclusive effect of going along with an earlier administrative adjudication.

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3. Regulatory Guidance

The newly accessible federal forum also impacts how agencies can interpret their own regulations under *Auer* deference (sometimes called *Seminole Rock* deference). *Auer* deference is to regulations what *Chevron* was to statutes: under *Auer* deference, courts defer to reasonable agency interpretations of ambiguous regulations.[8] Courts do not, however, usually defer to agency interpretations asserted for the first time during federal litigation (as opposed to those asserted throughout the administrative process).[9] Therefore, after *Jarkesy*, agencies will be incentivized to publish detailed guidance to regulated parties before hoping to rely on their interpretations in federal court. By the same token, agencies will lose some opportunities to rely on case-by-case administrative adjudications to develop that guidance over time.

Also, courts often refuse to grant *Auer* deference for interpretations that do not depend on the agency's subject-matter expertise,[10] and therefore, judicial opinions will become a more frequent source of regulatory guidance for non-technical regulations, supplanting the agencies' often prosecution-friendly interpretations of the same regulations. The increased number of federal lawsuits, however, may lead to an increased number of conflicting judicial interpretations, which would require agencies to rely more often on notice-and-comment rulemaking to informally overturn negative precedent and maintain consistent regulatory priorities.

Faced with this new onslaught of regulatory disputes, courts may also tend to adopt one of two interpretative approaches that predominated under *Chevron* deference: i.e., finding that canons of interpretation never leave a genuine ambiguity that warrants relying on deference or implicitly finding that an agency's reasonable interpretation is the legally correct one, despite a reasonable competing interpretation. Either way, as the gatekeepers of deference, courts will take on a more active role in deciding the meaning of various regulations that will soon come before them.

The combined effect of *Auer* and *Jarkesy* is that a regulated party has an increased chance of successfully challenging an agency's regulatory interpretation where (1) the agency failed to provide

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enough notice of its reading ahead of the prosecution; or (2) the regulated party's competing interpretation is more persuasive on a matter outside of the agency's expertise.

Key Takeaways

While *Jarkesy* and other decisions are monumental, the administrative state is, by no means, dismantled. Regulated parties should remain vigilant about their regulatory obligations and expect that violations will result in administrative tribunals for a host of regulatory punishments, including punitive fines preceded by or following federal court prosecutions. As agencies, parties, and courts grapple with the impact of the Supreme Court's recent term, Frost Brown Todd is here to help businesses and individuals navigate the new terrain as they seek to maintain profitable businesses and minimize legal risk. For more information concerning the implications of *Jarkesy* or for guidance on other regulatory and administrative law issues, please contact the author or any attorney with the firm's Appellate and Business and Commercial Litigation practices.

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[1] 603 U.S. 369 (2024).

[2] 603 U.S. 799 (2024).

[3] 603 U.S. 109 (2024).

[4] *Id.*. at 122.

[5] Some include, the FTC, the CFPB, EPA, FDA, and OSHA.

[6] *Jarkesy*, 603 U.S. at 123 ("In this case, the remedy is all but dispositive.").

[7] *Jarkesy*, 603 U.S. at 119.

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[8] *Kisor v. Wilkie*, 588 U.S. 558, 573 (2019) (citing *Auer v. Robbins*, 519 U.S. 452 (1997)).

[9] *Id.* at 579 n. 6.

[10] *Id.* at 577–78.

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