Securities Regulation

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Chapter 7 — Due Diligence and Securities Act Liability in Registered and Public Offerings

§ 7.02 The Registered Offering — Framework of Section 11

[B] Elements of the § 11 Right of Action

On page 392, delete the Ninth Circuit's decision in Pirani v. Slack Technologies, Inc. and add:

Slack Technologies, LLC v. Pirani

United States Supreme Court
143 S. Ct. 1433 (2023)

JUSTICE GORSUCH delivered the opinion of the Court.

This case concerns the meaning of one provision of the federal securities laws. For many years, lower federal courts have held that liability under §11 of the Securities Act of 1933 attaches only when a buyer can trace the shares he has purchased to a false or misleading registration statement. Recently, the Ninth Circuit parted ways with these decisions, holding that a plaintiff may sometimes recover under §11 even when the shares he owns are not traceable to a defective registration statement. The question we face is which of these approaches best conforms to the statute's terms.

I

Together, the Securities Act of 1933 and the Securities Exchange Act of 1934 form the backbone of American securities law. The first is "narrower" and focused "primarily" on the regulation of new offerings. Generally speaking, the 1933 Act requires a company to register the securities it intends to offer to the public with the Securities and Exchange Commission (SEC). As part of that process, a company must prepare a registration statement that includes detailed information about the firm's business and financial health so prospective buyers may fairly assess whether to invest. The law imposes strict liability on issuing companies when their registration statements contain material misstatements or misleading omissions.

The 1934 Act sweeps more broadly. Among other things, it requires publicly traded companies to provide ongoing disclosures and regulates trading on secondary markets. This law's main liability provision [§10(b)] sweeps more broadly too. It allows suits in connection with the purchase or sale of "any security," whether registered or not. But to prevail under this provision [namely, §10(b)], a plaintiff must prove that any material misleading statement or omission was made "with scienter, *i.e.*, with intent to deceive, manipulate, or defraud."

This case arises from a public offering governed by the 1933 Act. Typically, when a company goes public it issues new shares pursuant to a registration statement. That registration statement is filed with the SEC and made available to the public. Investment banks underwrite the offering, usually by buying these new registered shares at a negotiated price and then selling them to investors at a higher price. In this way, underwriters often carry the risk of loss should they fail to sell the shares at a profit.

Of course, a company's early investors and employees may own preexisting shares. Often, too, these shares are not subject to registration requirements…. To prevent the stock price from falling once public trading begins, underwriters may require insiders to consent to a "lockup agreement"—a commitment to hold their unregistered shares for a period of time before selling them on the new public market.

Initial public offerings (IPOs) are an effective way of raising capital, but they also have drawbacks. Among other things, they can involve significant transaction costs. Nor is raising capital the only reason firms might wish to go public; some may simply wish to afford their shareholders (whether investors, employees, or others) the convenience of being able to sell their existing shares on a public exchange. Several years ago, a number of companies approached the New York Stock Exchange (NYSE) about the possibility of selling shares publicly on that exchange without an IPO. Ultimately, the NYSE proposed rules to facilitate and regulate these "direct listings," which the SEC approved with modifications ….

Slack is a technology company that offers a platform for instant messaging. It conducted a direct listing on the NYSE in 2019. As part of that process, Slack filed a registration statement for a specified number of registered shares it intended to offer in its direct listing. But because Slack employed a direct listing rather than an IPO, there was no underwriter and no lockup agreement. Accordingly, holders of preexisting unregistered shares were free to sell them to the public right away. All told, Slack's direct listing offered for purchase 118 million registered shares and 165 million unregistered shares.

Fiyyaz Pirani bought 30,000 Slack shares on the day Slack went public. He bought 220,000 additional shares over the next few months. When the stock price later dropped, Mr. Pirani filed a class-action lawsuit against Slack. In that suit, he alleged that Slack had violated §§11 and 12 of the 1933 Act by filing a materially misleading registration statement.

Slack moved to dismiss the complaint for failure to state a claim. Sections 11 and 12, Slack argued, authorized suit only for those who hold shares issued pursuant to a false or misleading registration statement. And this feature of the law, the company said, was dispositive in this case because Mr. Pirani had not alleged that he purchased shares traceable to the allegedly misleading registration statement. For all anyone could tell, he may have purchased unregistered shares unconnected to the registration statement and its representations about the firm's business and financial health. Of course, Slack would go on to acknowledge that the 1934 Act allows investors to recover for fraud in the sale of unregistered shares upon proof of scienter [pursuant to §10(b)]. But, the company emphasized, Mr. Pirani had not sought to sue under that law.

Ultimately, the district court denied the motion to dismiss but certified its ruling for interlocutory appeal. The Ninth Circuit accepted the appeal and a divided panel affirmed. 13 F. 4th, at 945, 950 [(9th Cir. 2021)]. In dissent, Judge Miller argued that §§11 and 12 of the 1933 Act require a plaintiff to plead and prove that he purchased securities registered under a materially misleading registration statement, something Mr. Pirani had not done. Judge Miller pointed out that a long line of lower court cases have interpreted §11 as applying only to shares purchased pursuant to a registration statement. Because the Ninth Circuit's decision created a split of authority in the courts of appeals about §11's scope, we granted certiorari.[1]

II

We begin with the relevant language of §11(a) of the 1933 Act. It provides:

> "In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue [certain enumerated parties]."

The statute authorizes an individual to sue for a material misstatement or omission in a registration statement when he has acquired "such security." The question we face is what this means. Does the term "such security" refer to a security issued pursuant to the allegedly misleading registration statement? Or can the term also sometimes encompass a security that was not issued pursuant to the allegedly misleading registration statement? Slack advances the first interpretation; Mr. Pirani defends the second.

Immediately, we face a bit of a challenge. The word "such" usually refers to something that has already been "described" or that is "implied or intelligible from the context or circumstances." Concise Oxford Dictionary of Current English 1218 (1931); see also Webster's New International Dictionary 2518 (2d ed. 1954). But there is no clear referent in §11(a) telling us what "such security" means. As a result, we must ascertain the statute's critical referent "from the context or circumstances."

As it turns out, context provides several clues. For one thing, the statute imposes liability for false statements or misleading omissions in "*the* registration statement." §77k (emphasis

[1] The parties have litigated this case on the premise that Slack was not required to register all of the shares sold in its direct listing. For the first time before this Court, Mr. Pirani challenges that premise, suggesting that it was incumbent on Slack to register all the securities sold in its direct listings on the NYSE. Brief for Respondent 11-12, n. 7. As he acknowledges, however, this issue is not properly presented for decision, and so we do not pass upon it.

added). Not just a registration statement or any registration statement. The statute uses the definite article to reference the particular registration statement alleged to be misleading, and in this way seems to suggest the plaintiff must "acquire[e] such security" under that document's terms.

For another thing, the statute repeatedly uses the word "such" to narrow the law's focus. The statute directs us to "such part" of the registration statement that contains a misstatement or misleading omission. It speaks of "such acquisition" when a person has acquired securities pursuant to the registration statement. And it points to "such untruth or omission" found in the registration statement. Each time, the law trains our view on particular things or statements. All of which suggests that, when it comes to "such security," the law speaks to a security registered under the particular registration statement alleged to contain a falsehood or misleading omission.

Other provisions in the 1933 Act follow suit. Under § 5, for example, "[u]nless a registration statement is in effect as to a security," it is unlawful "to sell such security." Here, the term "such security" clearly refers to shares subject to registration. Meanwhile, § 6 provides that a "registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered." It's an instruction that would seem hard to square with Mr. Pirani's broader reading of §11(a)—after all, adopting that reading would give the registration statement effect (in the sense of creating liability) for securities that are not "specified" in the registration statement "as proposed to be offered."

Beyond these clues lies still another. Section 11(e) caps damages against an underwriter in a §11 suit to the "total price at which the securities underwritten by him and distributed to the public were offered to the public." This provision thus ties the maximum available recovery to the value of the registered shares alone. It's another feature that makes little sense on Mr. Pirani's account, for if §11(a) liability extended beyond registered shares presumably available damages would too.

Collectively, these contextual clues persuade us that Slack's reading of the law is the better one. Nor is anything we say here particularly novel. For while direct listings are new, the question how far §11(a) liability extends is not. More than half a century ago, Judge Friendly addressed the question in an opinion for the Second Circuit in *Barnes* and concluded that "the narrower reading" we adopt today is the more "natural" one. 373 F.2d, at 271, 273 [(2d Cir. 1967)]. Since *Barnes*, every court of appeals to consider the issue has reached the same conclusion: To bring a claim under §11, the securities held by the plaintiff must be traceable to the particular registration statement alleged to be false or misleading. Until this decision, even the Ninth Circuit seemed to take the same view. *Hertzberg v. Dignity Partners, Inc*., 191 F. 3d 1076, 1080, and n. 4 (1999).

Resisting this conclusion, Mr. Pirani argues that we should read the phrase "such security" to include not only securities traceable to a defective registration statement. We should also read the phrase to include other securities that bear some sort of minimal relationship to a defective registration statement. And, he argues, a reading like that would allow his case to proceed because, but for the existence of Slack's registration statement for the registered shares, its unregistered shares would not have been eligible for sale to the public. Beyond assuring us that the rule he proposes would save his case, however, Mr. Pirani does not offer much more. He does not explain what the limits of his rule would be, how we might derive them from §11, or how any of this can be squared with the various contextual clues we have encountered suggesting that liability runs with registered shares alone.

Perhaps the closest Mr. Pirani comes to answering these questions comes when he directs us to § 5. If Congress wanted liability under §11(a) to attach only to securities issued pursuant to a particular registration statement, he observes, it could have simply borrowed similar language from § 5. That provision, he stresses, speaks of "any security with respect to which a registration statement has been filed." But even taken on its own terms, this argument does not prove much. If Mr. Pirani's example shows that Congress could have written §11(a) to explain more clearly that liability attaches only to securities issued pursuant to a particular registration statement, it also shows that Congress could have written §11(a) to explain more clearly that liability attaches to "any security" or "any security" bearing some specified relationship to a registration statement. That Congress could have been clearer, no one disputes. But none of this proves it adopted anything like the rule Mr. Pirani proposes.

Finally, Mr. Pirani argues from policy and purpose. Adopting a broader reading of "such security" would, he says, expand liability for falsehoods and misleading omissions and thus better accomplish the purpose of the 1933 Act. We cannot endorse this line of reasoning. This Court does not "presume . . . that any result consistent with [one party's] account of the statute's overarching goal must be the law." Nor, for that matter, is Mr. Pirani's account of the law's purpose altogether obvious. As we have seen, the 1933 Act is "limited in scope." Its main liability provision imposes strict liability on issuers for material falsehoods or misleading omissions in the registration statement. Meanwhile, the 1934 Act requires ongoing disclosures for publicly traded companies and its main liability provision [§10(b)] allows suits involving any sale of a security but only on proof of scienter. Given this design, it seems equally possible that Congress sought a balanced liability regime that allows a narrow class of claims to proceed on lesser proof but requires a higher standard of proof to sustain a broader set of claims.

III

Naturally, Congress remains free to revise the securities laws at any time, whether to address the rise of direct listings or any other development. Our only function lies in discerning and applying the law as we find it. And because we think the better reading of the particular provision before us requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement, we vacate the Ninth Circuit's judgment holding otherwise. Whether Mr. Pirani's pleadings can satisfy §11(a) as properly construed, we leave for that court to decide in the first instance on remand.[2]

It is so ordered.

Note

Thus, the Supreme Court in *Slack Industries* adhered to the longstanding "tracing" requirement. Plaintiffs therefore must prove that they purchased shares that were registered under the allegedly deficient registration statement in order to sue under Section 11. From a historical perspective, the tracing requirement signifies that secondary market purchasers often find this barrier insurmountable to hurdle when the secondary market includes both shares that were sold in the subject registered offering as well as other shares (that were registered in prior offerings or entered the secondary market by private resales, such as pursuant to Rule 144). Nonetheless, as a brief filed in *Slack Industries* explains, the tracing requirement no longer may be a showstopper precluding the bringing of Section 11 claims:

> The decades-old folk wisdom is that tracing securities to a newly issued registration statement is "often impossible" because "most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares," and "many brokerage houses do not identify specific shares with particular accounts but instead treat the account as having an undivided interest in the house's position."….
>
> These pronouncements were, at one time, reasonable. But today they rest on antiquated assumptions. Modern computing power makes it technologically feasible to trace the purchase of securities to an allegedly misleading registration statement. Broker-dealers, exchanges and FINRA [The Financial Industry Regulatory Authority] are required by law to maintain detailed, time-stamped

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[2] As we noted at the outset, the parties do not just spar over the best interpretation of §11 and its application to this case. They do the same when it comes to §12. But we have no need to reach the merits of that particular dispute. The Ninth Circuit said that its decision to permit Mr. Pirani's §12 claim to proceed "follow[ed] from" its analysis of his §11 claim. 13 F. 4th 940, 949 (2021). And because we find that court's §11 analysis flawed, we think the best course is to vacate its judgment with respect to Mr. Pirani's §12 claim as well for reconsideration in the light of our holding today about the meaning of §11. In doing so, we express no views about the proper interpretation of §12 or its application to this case. Nor do we endorse the Ninth Circuit's apparent belief that §11 and §12 necessarily travel together, but instead caution that the two provisions contain distinct language that warrants careful consideration.

transactional records which can be obtained through discovery…. These records show exactly when securities in one account are transferred to another account, whether within the same broker-dealer or between different broker-dealers. Moreover, today all these records are contained in a central repository known as the Consolidated Audit Trail (CAT), such that there is no need for plaintiffs to subpoena individual broker-dealers. This makes it possible to reconstruct a reliable "chain of title," … using standard accounting methods like first in-first out (FIFO) or last in-last out (LILO).

Brief for Amici Curiae Law and Business Professors in Support of Respondent, at pages 5-6 (citations omitted).

Chapter 8 — Section 10(b) and Related Issues

§ 8.01 Overview

Duty to Disclose

On page 498, add:

Macquarie Infrastructure Corporation v. Moab Partners, L.P.

United States Supreme Court

144 S. Ct. 885 (2024)

JUSTICE SOTOMAYOR delivered the opinion of the Court.

Securities and Exchange Commission (SEC) Rule 10b-5(b) makes it unlawful to omit material facts in connection with buying or selling securities when that omission renders "statements made" misleading. Separately, Item 303 of SEC Regulation S-K requires companies to disclose certain information in periodic filings with the SEC. The question in this case is whether the failure to disclose information required by Item 303 can support a private action under Rule 10b-5(b), even if the failure does not render any "statements made" misleading. The Court holds that it cannot. Pure omissions are not actionable under Rule 10b-5(b).

I

A

Section 10(b) of the Securities Exchange Act of 1934 makes it "unlawful for any person ... [t]o use or employ, in connection with the purchase or sale of any security …[,] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." Rule 10b-5 implements this prohibition and makes it unlawful for issuers of registered [and unregistered] securities to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." This Court "has found a right of action implied in the words of [§10(b)] and its implementing regulation."

Section 13(a) of the Exchange Act requires issuers to file periodic informational statements. These statements include the "Management's Discussion and Analysis of Financial Conditions and Results of Operation" (MD&A), in which companies must "[f]urnish the information required by Item 303 of Regulation S-K." See SEC Form 10-K; SEC form 10-Q. Item 303, in turn, requires companies to "[d]escribe any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

B

Macquarie Infrastructure Corporation owns infrastructure-related businesses, including a subsidiary that operates large "bulk liquid storage terminals" within the United States. These terminals handle and store liquid commodities, such as petroleum, biofuels, chemicals, and oil products. One liquid commodity stored in these terminals is No. 6 fuel oil, a high-sulfur fuel oil that is a byproduct of the refining process. In 2016, the United Nations' International Maritime Organization formally adopted IMO 2020, a regulation that capped the sulfur content of fuel oil used in shipping at 0.5% by the beginning of 2020. No. 6 fuel oil typically has a sulfur content closer to 3%. In the ensuing years, Macquarie did not discuss IMO 2020 in its public offering documents. In February 2018, however, Macquarie announced that the amount of storage capacity contracted for use by its subsidiary's customers had dropped in part because of the structural decline in the No. 6 fuel oil market. Macquarie's stock price fell around 41%.

Moab Partners, L.P. sued Macquarie and various officer defendants, alleging, among other things, a violation of §10(b) and Rule 10b-5. The crux of Moab's argument was that Macquarie's public statements "were false and misleading" because it "concealed from investors that [its subsidiary's] storage capacity was devoted to No. 6 fuel oil," which "faced a near-cataclysmic ban on the bulk of its widespread use through IMO 2020." In Moab's view, Macquarie had "'a duty to disclose' the extent to which [its subsidiary's] storage capacity was devoted to No. 6 fuel oil," but instead, Macquarie "violated disclosure obligations under Item 303," and therefore violated §10(b) and Rule 10b-5. The District Court dismissed Moab's complaint, concluding in relevant part that Moab had not "actually plead[ed] an uncertainty that should have been disclosed" or "in what SEC filing or filings Defendants were supposed to disclose it."

The Second Circuit reversed. The court reasoned that there are "two circumstances which impose a duty on a corporation to disclose omitted facts." First, a duty arises when there is "a statute or regulation requiring disclosure,' . . . such as Ite[m] 303." Second, "[e]ven when there is no existing independent duty to disclose information, once a company speaks on an issue or topic, there is a duty to tell the whole truth." "Crediting [Moab's] allegations as true, IMO 2020's significant restriction of No. 6 fuel oil use was known to [Macquarie] and reasonably likely to have material effects on [Macquarie's] financial condition or results of operation." Because Moab had "adequately alleged a 'known trend[] or uncertaint[y]' that gave rise to a duty to disclose under Item 303," the court applied its binding precedent to conclude that Macquarie's Item 303 violation alone could sustain Moab's §10(b) and Rule 10b-5 claim. ("The failure to make a material disclosure required by Item 303 can serve as the basis . . . for a claim under Section 10(b)").

The courts of appeals disagree on whether a failure to make a disclosure required by Item 303 can support a private claim under §10(b) and Rule 10b-5(b) in the absence of an otherwise-misleading statement. This Court granted certiorari to resolve that disagreement.

II

Rule 10b-5(b) makes it unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." This Rule accomplishes two things. It prohibits "any untrue statement of a material fact"—*i.e.,* false statements or lies. It also prohibits omitting a material fact necessary "to make the statements made . . . not misleading." This case turns on whether this second prohibition bars only half-truths or instead extends to pure omissions.

A pure omission occurs when a speaker says nothing, in circumstances that do not give any particular meaning to that silence. Take the simplest example. If a company fails entirely to file an MD&A, then the omission of particular information required in the MD&A has no special significance because no information was disclosed. Half-truths, on the other hand, are "representations that state the truth only so far as it goes, while omitting critical qualifying information." "A classic example of an actionable half-truth in contract law is the seller who reveals that there may be two new roads near a property he is selling, but fails to disclose that a third potential road might bisect the property." In other words, the difference between a pure omission and a half-truth is the difference between a child not telling his parents he ate a whole cake and telling them he had dessert.

Rule 10b-5(b) does not proscribe pure omissions. The Rule prohibits omitting material facts necessary to make the "statements made . . . not misleading." Put differently, it requires disclosure of information necessary to ensure that statements already made are clear and complete (*i.e.*, that the dessert was, in fact, a whole cake). This Rule therefore covers half-truths, not pure omissions. Logically and by its plain text, the Rule requires identifying affirmative assertions (*i.e.*, "statements made") before determining if other facts are needed to make those statements "not misleading." It once again "bears emphasis that §10(b) and Rule 10b-5(b) do not create an affirmative duty to disclose any and all material information. Disclosure is required under these provisions only when necessary 'to make . . . statements made, in the light of circumstances under which they were made, not misleading."

Statutory context confirms what the text plainly provides. Congress imposed liability for pure omissions in §11(a) of the Securities Act of 1933. Section 11(a) prohibits any registration statement that "contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading. By its terms, in addition to proscribing lies and half-truths, this section also creates liability for failure to speak on a subject at all. See *Omnicare*, 575 U.S., at 186, n. 3 ("Section 11's omissions clause also applies when an issuer fails to make mandated disclosures—those 'required to be stated'—in a registration statement"). There is no similar language in §10(b) or Rule 10b-5(b). Neither Congress in §10(b) nor the SEC in Rule 10b-5(b) mirrored §11(a) to create liability for pure omissions. That omission (unlike a pure omission) is telling.

"Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic Inc. v. Levinson*, 485 U.S. 224, 239, n. 17 (1988). Even a duty to disclose, however, does not automatically render silence misleading under Rule 10b-5(b). Today, this Court confirms that the failure to disclose information required by Item 303 can support a Rule 10b-5(b) claim only if the omission renders affirmative statements made misleading.

Moab and the United States suggest that a plaintiff does not need to plead any statements rendered misleading by a pure omission because reasonable investors know that Item 303 requires an MD&A to disclose all known trends and uncertainties. That argument fails, however, because it reads the words "statements made" out of Rule 10b-5(b) and shifts the focus of that rule and §10(b) from fraud to disclosure. It would also render §11(a)'s pure omission clause superfluous by making every omission of a fact "required to be stated" a misleading half-truth.

Moab also contends that without private liability for pure omissions under Rule 10b-5(b), there will be "broad immunity any time an issuer fraudulently omits information Congress and the SEC require it to disclose." That is not so. For one thing, private parties remain free to bring claims based on Item 303 violations that create misleading half-truths. For another, the SEC retains authority to prosecute violations of its own regulations. The Exchange Act requires that issuers file reports "in accordance with such rules and regulations as the Commission may prescribe," and the SEC can investigate "whether any person has violated . . . any provision of the [the Exchange Act], [or] the rules and regulations thereunder," including Item 303.

Moab and the United States spill much ink fighting the question presented, insisting that this case is about half-truths rather than pure omissions. The Court granted certiorari to address the Second Circuit's pure omission analysis, not its half-truth analysis. See Pet. for Cert. i ("Whether . . . a failure to make a disclosure required under Item 303 can support a private claim under Section 10(b), *even in the absence of an otherwise-misleading statement"* (emphasis added)); see also 2022 WL 17815767, *1 (Dec. 20, 2022) (distinguishing between these "two circumstances"). The Court does not opine on issues that are either tangential to the question presented or were not passed upon below, including what constitutes "statements made," when a statement is misleading as a half-truth, *or whether rules 10b-5(a) and 10b-5(c) support liability for pure omissions [emphasis supplied]. [This footnote is placed in the text-editor.]*

* * *

Pure omissions are not actionable under Rule 10b-5(b). The judgment of the Court of Appeals for the Second Circuit is vacated, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

§ 8.02 Standing: The Purchaser-Seller Requirement

On page 507, add:

Menora Mivtachim Insurance Ltd. v. Frutarom Industries Ltd.

United States Court of Appeals, Second Circuit

54 F.4th 82 (2022)

Park, Circuit Judge:

International Flavors & Fragrances Inc. ("IFF"), a U.S.- based seller of flavoring and fragrance products, acquired Frutarom Industries Ltd. ("Frutarom"), an Israeli firm in the same industry. Leading up to the merger, Frutarom allegedly made material misstatements about its compliance with anti-bribery laws and the source of its business growth. Plaintiffs, who bought stock in IFF, sued Frutarom, alleging that those misstatements violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. We conclude that Plaintiffs lack statutory standing to sue. Under the purchaser-seller rule, standing to bring a claim under Section 10(b) is limited to purchasers or sellers of securities issued by the company about which a misstatement was made. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). Plaintiffs here lack standing to sue based on alleged misstatements that Frutarom made about itself because they never bought or sold shares of Frutarom. We thus affirm the district court's dismissal of the complaint.

I. BACKGROUND

A. Factual Background

Plaintiffs are a putative class of investors who acquired IFF securities between May 7, 2018 and August 12, 2019. They allege that from 2002 to 2018, Frutarom's executives engaged in a "long-running bribery scheme" by which they bribed key employees of important clients in order to "generate continued and increased business with the customer[s]." They also bribed customs officials and quality assurance officials in Russia and Ukraine in order to import Frutarom products into those countries and to pass local certifications of product fitness.

On May 7, 2018, Frutarom and IFF announced an anticipated merger. Plaintiffs allege that leading up to the consummation of the merger, Frutarom made materially misleading statements about its compliance with anti-bribery laws and the sources of its business growth, most of which were incorporated into IFF's Form S-4 Registration Statement….

IFF's acquisition of Frutarom closed in October 2018, after which Frutarom became a wholly-owned subsidiary of IFF. On August 5, 2019, IFF acknowledged that Frutarom had "made improper payments to representatives of a number of customers" in Russia and Ukraine. The following day, IFF's share price dropped nearly 16%.

B. Procedural History

Plaintiffs sued IFF and two of its officers as well as Frutarom and five of its officers. Plaintiffs alleged that Defendants' materially misleading misstatements violated Sections 10(b) and 20(a) of the Exchange Act; and Securities and Exchange Commission ("SEC") Rule 10b-5.

The district court granted Defendants' motion to dismiss….

II. DISCUSSION

A. Standard of Review

We review a district court's dismissal of a complaint under [Federal Rule of Civil Procedure] 12(b)(6) de novo….

B. The Purchaser-Seller Rule

Neither Section 10(b) of the Exchange Act nor Rule 10b-5 provides an express private right of action, but the Supreme Court has long held that one is implied… Recognizing the advantages of limitations to this judicially created private right of action, the Court in *Blue Chip Stamps* adopted the rule from *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461 (2d Cir. 1952), which limited the class of plaintiffs who could sue under Rule 10b-5 to those who purchased or sold the securities of an issuer about which a material misstatement was made….

The Court observed in *Blue Chip Stamps* that "[a]vailable evidence from the texts of the [Securities Act of 1933 and the Exchange Act] … supports the result reached by the *Birnbaum* court." It also noted the fact that the purchaser-seller rule had gained widespread acceptance across the country and that Congress had "fail[ed] to reject *Birnbaum's* reasonable interpretation of the wording of § 10(b)" despite two attempts to amend the statute….

The Court expressed concern about "the danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5." And it warned against an "endless case-by-case erosion" of the purchaser-seller rule by creating exceptions, concluding that "such a shifting and highly fact-oriented disposition" of statutory standing is not a "satisfactory basis for a rule of liability imposed on the conduct of business transactions."

C. Application

The purchaser-seller rule requires plaintiffs to have bought or sold a security of the issuer about which a misstatement was made in order to have standing to sue under Section 10(b). Plaintiffs here lack statutory standing to sue Frutarom based on alleged misstatements that the company made about itself because they bought shares of IFF, not Frutarom.

As IFF shareholders, Plaintiffs argue that they have standing because there was a sufficiently "direct relationship" between Frutarom's misstatements about itself and the price of IFF's shares. This argument is meritless.

First, judicially created private rights of action should be construed narrowly. Plaintiffs urge us to read Section 10(b) "flexibly to effectuate its remedial purposes." *Blue Chip Stamps*, however, recognized the need to limit this judicially created private right of action. We thus apply the purchaser-seller rule as adopted by the Supreme Court in *Blue Chip Stamps.*

Second, adopting Plaintiffs' "direct relationship" test for standing would begin exactly the "endless case-by-case erosion" of the purchaser-seller rule about which *Blue Chip Stamps* warned. Under Plaintiffs' "direct relationship" test, standing would be a "shifting and highly fact-oriented" inquiry, requiring courts to determine whether there was a sufficiently direct link between one company's misstatements and another company's stock price. For example, Plaintiffs point to joint press releases, IFF's SEC filings and investor presentations, and investment bank reports about IFF's acquisition of Frutarom to show a direct relationship between Frutarom's misstatements and IFF's stock. *Blue Chip Stamps* cautioned against adding further uncertainty to Section 10(b)'s "rule of liability imposed on the conduct of business transactions." …

Third, Plaintiffs' reliance on dicta in *Nortel* [*Ontario Public Service Employees Union Pension Trust Fund v. Nortel Networks Corp.*, 369 F.3d 27 (2d Cir. 2004)] is misplaced. In *Nortel*, JDS Uniphase Corporation ("JDS") sold one of its business units to its largest customer, Nortel Networks Corporation ("Nortel") in exchange for Nortel stock. Plaintiffs, who were JDS shareholders, sued Nortel for allegedly misleading statements it made about itself leading up to the transaction. We held that plaintiffs lacked standing because "[s]tockholders do not have standing to sue under Section 10(b) and Rule 10b-5 when the company whose stock they purchased is negatively impacted by the material misstatement of another company, whose stock they do not purchase."

Notwithstanding the holding of the case, Plaintiffs argue that *Nortel* would have found standing if there had been a sufficiently "direct relationship" between Nortel's statements and JDS's stock price. They point to dicta noting that because "a merger creates a far more significant relationship between two companies than does the sale of a business unit," "a potential merger might require a different outcome." But we said that was "a question that we leave for another day and about which we express no opinion." For the reasons explained above, we now answer that question by holding that purchasers of a security of an acquiring company do not have standing under Section 10(b) to sue the target company for alleged misstatements the target company made about itself prior to the merger between the two companies.

Nor does our subsequent decision *In re NYSE Specialists Securities Litigation*, 503 F.3d 89 (2d Cir. 2007) ("*NYSE Specialists*"), change this result. In that case, we clarified that *Nortel* did not preclude purchasers of a stock from suing "underwriters, brokers, bankers, and non-issuer sellers" under Rule 10b-5. That is entirely consistent with the purchaser-seller rule: Plaintiffs may be able to sue entities other than the issuer of a security if those entities made material misstatements about the issuer, as long as the plaintiffs purchased or sold the securities of the issuer about which the misstatements were made.

ln short, Section 10(b) standing does not depend on the significance or directness of the relationship between two companies. Rather, the question is whether the plaintiff bought or sold shares of the company about which the misstatements were made. *See Nortel* 369 F. 3d at 32 (stating that the plaintiffs' argument that they had standing was "entirely at odds with the purchaser-seller requirement in *Blue Chip Stamps* that 'limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates.' " Our conclusion follows directly from our decision in *Nortel*. In both cases, a company whose stock the plaintiffs did not purchase made material misstatements about itself that negatively impacted another company's stock, which plaintiffs did purchase. The fact that this case involved a merger instead of the sale of a business unit and that IFF incorporated some of Frutarom's misstatements in its SEC filings and investor presentations does not change the analysis here. Plaintiffs did not purchase securities of the issuer about which misstatements were made, so they did not have standing to sue under Section 10(b) or Rule 10b-5.

III. CONCLUSION

For the reasons set forth above, the district court's judgment is affirmed.

***Pérez, Circuit Judge, concurring in the judgment*:**

I respectfully submit that this Court need not have created new law to dispose of this case and could have resolved the question presented by applying this Circuit's reasoning in *Ontario Public Service Employees Union Pension Trust Fund v. Nortel Networks Corp.,* 369 F.3d 27 (2d Cir. 2004) ("*Nortel"*). Because I, however, agree with the majority opinion that plaintiff IFF investors ("Plaintiffs") lack statutory standing to sue Frutarom and its former executives based on the alleged misstatements that Frutarom made about itself, I concur in the judgment.

….

Today this Court also makes a choice. It holds that standing to bring a claim under Section 10(b) and Rule 10b-5 is limited to purchasers or sellers of securities issued by the company about which a misstatement was made. This holding is unsurprising given the Supreme Court and our Court's historically "restrictive view of standing under Rule 10b-5." It is also a defensible answer to the question left open by *Nortel.*

But this Court need not have created new law to resolve this case. We have twice interpreted or applied *Nortel's* holding and analysis regarding statutory standing. *See In re NYSE Specialists Sec. Litig.*, 503 F.3d 89 (2d Cir. 2007) ("*NYSE Specialists*"); *Harbinger Cap. Partners LLC v. Deere & Co.*, 632 F. App'x 653 (2d Cir. 2015) (*"Harbinger"*) (summary order). And as in *Nortel* and *Harbinger*, Plaintiffs lack standing because, under the circumstances of the case, the relationship between one company's material misstatements about itself and another company's stock price was "too remote to sustain an action" under Section 10(b) and Rule 10b-5. We could have decided this case on an application of *Nortel* (as happened in *Harbinger*), thus leaving open the question *Nortel* raised and allowing for future consideration of other fact patterns by this Court and the trial courts.

….

It is important to acknowledge today's holding is an example of judicial policymaking.

Of course, the Supreme Court has endorsed judicial policymaking in this securities context. *See Blue Chip Stamps*, 421 U.S. at 749 ("Given the peculiar blend of legislative, administrative, and judicial history which now surrounds Rule 10b-5, we believe that practical factors … are entitled to a good deal of weight.") ….

Indeed, this Court has previously relied on these "policy considerations," among other factors, to define the scope of this private right of action.…

By rejecting *Nortel*'s "direct relationship" test here, the majority opinion similarly reflects a policy choice. The advantages of formalism in the law of business transactions are sensibly described in the majority opinion, but, as noted in *Blue Chip Stamps*, there are disadvantages to such rigidity …. Openly acknowledging the value judgments behind judicial decisions benefits all stakeholders to the judicial process, including the other branches of government and the public.

Given the Court's decision today, Congress can choose to ratify this Court's holding if it has the inclination and occasion to do so.… And Congress also can amend the Exchange Act, if in its view, this Court erred today.

Note

Several district court decisions subsequently have disagreed with the Second Circuit's decision in *Frutarom*. For example the federal district court In *Mullen Auto Securities Litigation* 2023 WL 8125447 at *6 (C.D. Cal. 2023), found the Second Circuit's approach "unpersuasive," asserting that it "failed to ensure 'confidence in the markets,' ignored that the Supreme Court has also rejected limitations on the Section 10(b) right of action in some circumstances, and overlooked that limiting standing in such a manner would be redundant with Section 10(b)'s materiality analysis." For a law review article critical of *Frutarom* and recommending an alternative approach, *see* Marc I. Steinberg and Antonio R. Partida, *Undue Limitations in the Section 10(b) Purchaser-Seller Requirement*, 99 Tulane L. Rev. 1 (2024).

Chapter 10 — Secondary Liability

§ 10.03 Distinguishing Primary from Secondary Liability

[C] Reinvigorating "Scheme" Liability Under Rule 10b-5(a) and (c)

On page 714, add:

Securities and Exchange Commission v. Rio Tinto PLC

United States Court of Appeals, Second Circuit

41 F.4th 47 (2022)

Dennis Jacobs, Circuit Judge:

The Securities and Exchange Commission ("SEC") brought scheme liability claims in a 2017 enforcement action against Rio Tinto plc, Rio Tinto Limited, and its CEO and CFO, pursuant to Rule 10b-5(a) and (c), promulgated under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and pursuant to Section 17(a)(1) and (3) of the Securities Act of 1933 ("Securities Act"). Citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005) ("*Lentell*"), the United States District Court for the Southern District of New York dismissed the scheme liability claims in a March 2019 order on the ground that the conduct alleged constituted misstatements and omissions only, and is therefore an insufficient basis for scheme liability.

In 2020, the SEC urged the district court to reconsider the dismissal in light of the Supreme Court's intervening decision in *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019) ("*Lorenzo*"), which held that an individual who disseminated a false statement (but did not make it) could be liable under the scheme subsections. In the SEC's view, *Lorenzo* expanded the scope of scheme liability so that allegations of misstatements and omissions alone are sufficient to state a scheme liability claim. The district court denied reconsideration. *Lorenzo* observes that the subsections of Rule 10b-5 and Section 17(a) are not hermetically sealed. On this interlocutory appeal, the SEC contends that *Lorenzo* thereby abrogates *Lentell.* We disagree. While *Lorenzo* acknowledges that there is leakage between and among the three subsections of each provision, the divisions between the subsections remain distinct. Until further guidance from the Supreme Court (or in banc consideration here), *Lentell* binds: misstatements and omissions can form part of a scheme liability claim, but an actionable scheme liability claim also requires something beyond misstatements and omissions, such as dissemination. Accordingly, we affirm.

I

The question presented on appeal is whether misstatements and omissions — without more — can support scheme liability pursuant to Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) promulgated thereunder, and Securities Act Section 17(a)(1) and (3). The answer lies in the interplay of the three subsections of Rule 10b-5, and the interplay of the three subsections of Section 17(a). Rule 10b-5 and Section 17(a), which largely mirror each other, both consist of a "misstatement subsection" that is sandwiched between two "scheme subsections."

> Rule 10b-5 provides:
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

As clarified in *Janus Capital Group, Inc. v. First Derivative Traders,* 564 U.S. 135 (2011) (*"Janus"*), only the "maker" of a misstatement, i.e., the person with ultimate authority over the statement, can have primary liability under Rule 10b-5(b).

> Section 17(a) provides:
>
> It shall be unlawful for any person in the offer or sale of any securities... by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

II

The following background is based on the district court's recitation of the facts, as supplemented by allegations in the complaint.

In April 2011, defendants Rio Tinto plc and Rio Tinto Limited (together, "Rio Tinto") acquired an exploratory coal mine in Mozambique (the "Mine"). The Mine's $3.7 billion purchase price was premised on assumptions that the Mine would produce a certain volume and quality of coal, that the majority of the coal could be barged down the Zambezi River, and that the rest could be transported by existing rail infrastructure.

Over the ensuing months, the defendants learned that the coal quality was poorer than expected; that the Mozambican government would not permit transport of the coal by barge; and that the transport of coal by rail would require infrastructure costing upwards of $16 billion--and might not be permitted in any event. At a meeting in Brisbane on May 11, 2012, management from the Mine informed CEO Thomas Albanese and CFO Guy Robert Elliott that, based on the various emerging obstacles, the Mine's net present value was negative $680 million. (Albanese and Elliott are defendants in this action, along with Rio Tinto.)

In the months before and after the Brisbane meeting, Rio Tinto was issuing financial statements and preparing auditing papers. The complaint alleges that these documents contained false statements and omissions, including representations about transportation options and the amount and quality of coal reserves. Importantly, the SEC alleges that none of the documents disclosed that the Mine's valuation was impaired:

- The 2011 Annual Report, signed by Albanese and Elliott and filed with the SEC in March 2012, valued the Mine at its $3.7 billion acquisition price.

- A bond offering floated on the New York Stock Exchange that same month incorporated the 2011 Annual Report by reference.

- Rio Tinto's Controller's Group ("Controller") consolidated the information from the Mine for review during Audit Committee meetings, which were attended by Rio Tinto's independent auditors, as well as by Albanese and Elliott. Neither the First Controller's Paper (generated in advance of the June 18, 2012 Audit Committee meeting) nor the Second Controller's Paper (generated in advance of the July 30, 2012 Audit Committee meeting) identified impairment indicators or recorded an impairment.

- Rio Tinto submitted an "Impairment Paper" directly to its independent auditors, which likewise did not record an impairment or identify an impairment indicator.

- The Audit Committee and the independent auditors relied on the Controller's Papers and the Impairment Paper to decide whether to impair the Mine. Thus the Half Year 2012 Report ("HY2012 Report"), filed with the SEC on August 9, 2012, and signed by Albanese and Elliott, carried the Mine at a value of over $3 billion.

- Rio Tinto issued $3 billion in bonds a few days later, and the offerings incorporated the HY2012 Report and the 2011 Annual Report.

- The Third Controller's Paper (together with the First and Second Controller's Papers and the Impairment Paper, the "Papers"), which was prepared in advance of the

> November 26, 2012 Audit Committee meeting, likewise indicated a recoverable value of $4 to $5 billion (which meant that no impairment was likely to be required).

For their part, Rio Tinto's in-house valuation team disagreed with the over-$3 billion valuation. In August 2012, the team initiated a review that valued the Mine in the range of *negative* "$4.9 billion to $300 million." In late 2012, the head of the valuation team informed Albanese and Elliott about the shrunken valuation, and then informed the Chairman of Rio Tinto's Board. Following an investigation, at a meeting on January 15, 2013, the Board approved an 80 percent impairment, valuing the Mine at $611 million. In 2014, Rio Tinto again impaired the Mine, this time to $119 million. In October 2014, the Mine was sold for $50 million.

III

A

The SEC brought this twelve-count enforcement action on October 17, 2017, alleging that Rio Tinto should have taken an impairment on the Mine earlier than it did, and that the Papers, SEC filings, and the defendants failed to disclose the setbacks, or timely correct the valuation. At issue now are counts one and three, which allege that the defendants violated Rule 10b-5 and Section 17(a), respectively, by making fraudulent misstatements and omissions and by engaging in a scheme to defraud.

With respect to the misstatements and omissions claims, the SEC cited the 2011 Annual Report, the HY2012 Report, the Papers, the bond offerings, and statements made during various meetings and investor calls. With respect to the claims of scheme liability, the SEC cited corruption of the auditing process—specifically, the failure to correct statements made to the Audit Committee and auditors. The defendants moved to dismiss counts one and three for failure to state a claim on which relief can be granted.

Relevant to this appeal is the dismissal of the scheme liability claims. Citing *Lentell*, the Dismissal Order ruled that scheme liability does not exist when "the sole basis for such claims is alleged misrepresentations or omissions," and that here, all of the alleged "actions" and "conduct" forming the basis for scheme liability were misstatements or omissions. The district court pointed to certain examples of these misstatements and omissions, which included the 2011 Annual Report, statements in the bond offerings, false statements to shareholders, and the failure to disclose information learned at the Brisbane meeting.

About a week after the Dismissal Order was issued, the Supreme Court held in *Lorenzo* that an individual who disseminated a false statement, but who did not make it, could be liable under the scheme subsections. The SEC moved to reconsider the dismissal of the scheme liability claims, arguing that *Lorenzo* expanded the scope of the scheme subsections such that misstatements and omissions alone could form the basis for scheme liability.

The district court declined to reconsider, ruling that *Lorenzo* held that the dissemination of false information provides a basis for scheme liability--not that "misstatements alone are sufficient to trigger scheme liability." There is no allegation that the Rio Tinto defendants disseminated false statements; the SEC alleged "only that [the defendants] failed to prevent misleading statements from being disseminated by others."

B

As the procedural history shows, the SEC has exerted substantial effort to shoehorn its allegations into a claim for scheme liability. The SEC's position, however, would undermine two key features of Rule 10b-5(b).

For one, *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, (2011), limits primary liability under Rule 10b-5(b) to the "maker" of a statement; as neither Albanese nor Elliott made the statements in the Papers or the SEC filings, they cannot be primarily liable under Rule 10b-5(b). But with an expanded conception of scheme liability, the SEC might seek to prove that Albanese and Elliott are primarily liable under the scheme subsections for participation in the making of the misstatements.

Second, misstatements and omissions claims brought by private plaintiffs under Rule 10b-5(b) are subject to the heightened pleading standard of the Private Securities Litigation Reform Act ("PSLRA"). See 15 U.S.C. § 78u-4(b)(1) (a complaint alleging misleading statements or omissions "shall specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading"). But this heightened standard does not apply to allegations of scheme liability "[b]ecause scheme liability does not require an allegation that the defendant made a statement."

Expanding the scope of scheme liability would thereby lower the bar for primary liability for securities fraud, along with the pleading standard in cases involving private plaintiffs.

After the district court denied the SEC's motion for reconsideration, it certified the issue for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). This Court granted the petition for leave to appeal an interlocutory order. We are therefore called upon to determine whether, post- *Lorenzo*, misstatements and omissions alone can form the basis for scheme liability.

IV

The facts of *Lorenzo* bear upon whether reconsideration of the Dismissal Order is warranted.

As director of investment banking at an SEC-registered brokerage firm, *Lorenzo* sent two emails to prospective investors; the content of the emails was supplied by *Lorenzo's* boss and described a potential investment in a company that had "confirmed assets" of $10 million. *Lorenzo* knew, however, that the company recently disclosed that its total assets were worth under $400,000, and *Lorenzo* conceded scienter. The SEC brought enforcement proceedings against *Lorenzo* (among others).

Lorenzo held that the transmission of emails, or "dissemination," could sustain a claim under the scheme subsections that prohibit a "device," "scheme," "artifice to defraud," and/or fraudulent "practice." This language was held sufficiently broad to include dissemination.

Lorenzo further observed that there is "considerable overlap" between the subsections of Rule 10b-5 (and, similarly, between the subsections of Section 17(a)). *Lorenzo* rejected the view that only subsection (b) of Rule 10b-5 can regulate conduct involving false or misleading statements. So, even though *Lorenzo* did not make the false statement and his conduct was beyond the reach of Rule 10b-5(b), scheme liability was not precluded. Accordingly, the scheme subsections can cover conduct that involves a misstatement even if the defendant was not the maker of it.

V

This interlocutory appeal is limited to the legal issue raised in the SEC's motion for reconsideration: can misstatements and omissions *alone* form the basis for scheme liability? In our Circuit, this boils down to whether *Lorenzo* abrogated *Lentell*.

We rule that it did not. *Lentell* held that misstatements and omissions cannot form the "sole basis" for liability under the scheme subsections. 396 F.3d at 171. *Lorenzo* held that the "dissemination of false or misleading statements with intent to defraud" does come within the scheme subsections. But misstatements or omissions were not the sole basis for scheme liability in *Lorenzo*. The dissemination of those misstatements was key. Since the holdings of *Lentell* and *Lorenzo* are consistent with one another, *Lentell* remains vital.

On this narrow interlocutory appeal, we have no occasion to determine for ourselves whether the scheme liability claims in this complaint allege something beyond misstatements and omissions. Our analysis is premised on the district court's ruling in the Dismissal Order, which characterized the scheme liability claims as a collection of misstatements and omissions. Because *Lentell* withstands *Lorenzo*, and because the Dismissal Order ruled that the complaint alleges misstatements and omissions only, the district court did not abuse its discretion in declining to reconsider the dismissal of the scheme liability claims.

Whether there are ramifications or inferences from *Lorenzo* that blur the distinctions between the misstatement subsections and the scheme subsections is a matter that awaits further development…. As our opinion today is limited to the legal issue, we make no ruling about the ultimate impact of *Lorenzo* on this case. We do not consider, for example, whether corruption of an auditing process is sufficient for scheme liability under *Lorenzo*, or allegations that a corporate officer concealed information from auditors. For now, *Lentell* tells us that misstatements and omissions alone are not enough for scheme liability, and *Lorenzo* tells us that dissemination is one example of something extra that makes a violation a scheme.

We reject the SEC's argument that *Lentell* applies only in cases brought by private litigants. The SEC advances no credible basis for this argument; and courts have applied the principle of *Lentell* in enforcement actions….

VI

Maintaining distinctions between the subsections of Rule 10b-5 and between the subsections of Section 17(a) is consistent with the text of each. "One of the most basic interpretive canons is that a statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant."… Were misstatements and omissions alone sufficient to constitute a scheme, the scheme subsections would swallow the misstatement subsections. And though *Lorenzo* ruled that there was "considerable overlap" between the misstatement subsections and the scheme subsections, it did not announce that the misstatement subsections were subsumed. In concluding that *Lentell* remains vital, we are respecting the structure that Congress designed.

We know that *Lorenzo* preserved the lines between the subsections because *Lorenzo* emphasized the continued vitality of *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011). *Janus* limits primary liability under Rule 10b-5(b) to the "maker" of a statement, i.e., the person with authority over a false statement; individuals who helped draft, research, print, or wordsmith the statement at some point in time, but who lacked ultimate control, cannot be primarily liable. Using *Janus* as a backstop, *Lorenzo* signaled that it was not giving the SEC license to characterize every misstatement or omission as a scheme. While *Lorenzo* "may have carved out of *Janus*" liability for disseminating false statements, it did not go so far as to create primary liability for "participation in the preparation" of misstatements….

Preserving distinctions between the subsections also assures that private plaintiffs remain subject to the heightened pleading requirements for Rule 10b-5(b) claims. Section b(1) of the PSLRA requires a complaint alleging misstatements or omissions to "specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading," whereas "claims brought under Rule 10b-5(a) and (c) need not comport with provision (b)(1) of the PSLRA" because they do not require that a misstatement be made. An overreading of *Lorenzo* might allow private litigants to repackage their misstatement claims as scheme liability claims to "evade the pleading requirements imposed in misrepresentation cases."… But courts have prohibited plaintiffs from recasting their pleadings in this way…. *Lorenzo* did not announce a rule contravening this principle.

Finally, overreading *Lorenzo* would muddle primary and secondary liability. This matters because "[a]iding and abetting liability is authorized in actions brought by the SEC but not by private parties." To respect the line that Congress has drawn between primary and secondary liability, subsections (a) and (c) have been used historically only "to state a claim against a defendant for the underlying deceptive devices or frauds themselves, and not as a short cut to circumvent *Central Bank's* limitations on liability for a secondary actor's involvement in making misleading statements."…

The SEC's reading of *Lorenzo* would likely "revive in substance the implied cause of action against all aiders and abettors," thereby "undermin[ing] Congress' determination that this class of defendants should be pursued by the SEC and not private litigants…." In sum, a widened scope of scheme liability would defeat the congressional limitation on the enforcement of secondary liability, multiply the number of defendants subject to private securities actions, and render the statutory provision for secondary liability superfluous. It is telling that *Lorenzo* preserves the distinction between primary and secondary liability. See *Lorenzo*, 139 S. Ct. at 1103 ("We do not believe ... that our decision ... weakens the distinction between primary and secondary liability."); id. at 1104 ("The line we adopt today is just as administrable" as the " 'clean line' between conduct that constitutes a primary violation of Rule 10b-5 and conduct that amounts to a secondary violation" under *Central Bank* and *Janus*).

CONCLUSION

For the foregoing reasons, we conclude that the district court did not abuse its discretion when it declined to reconsider the dismissal of the scheme liability claims in light of *Lorenzo*. Accordingly, we affirm.

Chapter 12 — Insider Trading

§ 12.07 "Possession" versus "Use"

On page 818, add:

Rule 10b5-1 Amendments

Due to concerns that Rule 10b5-1 plans were being abused, the SEC in 2022 amended the Rule. As set forth by the Commission in the Fact Sheet, the 2022 amendments require additional conditions to establish an affirmative defense under Rule 10b5-1. These additional conditions include:

> [1] A cooling-off period for directors and officers of the *later of:* (1) 90 days following plan adoption or modification; or (2) two business days following the disclosure in certain periodic reports of the issuer's financial results in the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification) before any trading can commence under the trading arrangement [*note that issuers engaged in share repurchases are not subject to a cooling-off period*].
>
> [2] A cooling-off period of 30 days for persons other than issuers or directors and officers before any trading can commence under the trading arrangement or modification.
>
> [3] A condition for directors and officers to include a representation in their Rule 10b5-1 plan certifying, at the time of the adoption of a new or modified plan, that (1) they are not aware of material nonpublic information about the issuer or its securities; and (2) they are adopting the plan in good faith and not part of a plan or scheme to evade the prohibitions of Rule 10b-5.
>
> [4] A limitation on the ability of anyone other than issuers to use multiple overlapping Rule 10b5-1 plans.
>
> [5] A limitation on the ability of anyone other than issuers to rely on the affirmative defense to a single-trade plan to *one such plan during any consecutive 12-month period;* and
>
> [6] A condition that all persons entering into a Rule 10b5-1 plan must act in good faith with respect to that plan.

The 2022 amendments also require new disclosure mandates outside the parameters of Rule 10b5-1. As set forth in the SEC's Fact Sheet, these new disclosure requirements include:

> [1] Quarterly disclosure by registrants regarding the use of Rule 10b5-1 plans and certain other written trading arrangements by a registrant's directors and officers for the trading of its securities.

> [2] Annual disclosure of a registrant's insider trading policies and procedures.
>
> [3] Certain tabular and narrative disclosures regarding awards of options close in time to the release of material nonpublic information and related policies and procedures. [And]
>
> [4] A requirement that Form 4 and 5 filers [for the reporting of specified securities transactions by insiders, including officers and directors] indicate by checkbox that a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

Rule 10b5-1 provides another affirmative defense for trading parties that are entities. This defense is available as an alternative to the defense discussed above. Under the provisions of this defense, an entity will not be liable if it demonstrates that the individual responsible for the investment decision on behalf of the entity was not aware of the material inside information, and that the entity had implemented reasonable policies and procedures to prevent insider trading.

§ 15.03 Injunctions

[D] Disgorgement and Other Relief

On page 975, add:

Securities and Exchange Commission v. Govil

United States Court of Appeals Second Circuit

86 F.4th 89 (2023)

Menashi, Circuit Judge:

More than twenty years ago, Defendant-Appellant Aron Govil founded Cemtrex, Inc. ("Cemtrex" or the "Company"). He eventually took Cemtrex public and saw its common shares listed on the NASDAQ. In 2016 and 2017, however, Govil caused Cemtrex to engage in three fraudulent securities offerings. In those offerings, Govil represented to investors that the Company would use the proceeds from the transactions to satisfy outstanding debts and for general corporate purposes. Instead, he diverted over $7.3 million of the offering proceeds to his own private accounts.

The SEC quickly caught on. In advance of an enforcement action, Govil entered into two agreements — one with the SEC (the "Consent Agreement") and one with Cemtrex (the "Settlement"). In the Consent Agreement, Govil agreed broadly not to challenge the SEC's civil enforcement action. The Consent Agreement left unresolved whether there would be a disgorgement award relating to the three fraudulent Cemtrex offerings. In the Settlement, Govil agreed to surrender all Cemtrex securities in his control and to pay the Company over $1.5 million in the form of a secured promissory note. In exchange, Cemtrex released all private claims against Govil.

After filing its complaint and securing a partial judgment consistent with the Consent Agreement, the SEC moved for additional disgorgement of the approximately $7.3 million. Govil opposed the motion, but the district court decided that disgorgement was available. It credited the $1.5 million due under the secured promissory note as a payment in satisfaction of disgorgement, but it disregarded the securities that Govil surrendered to Cemtrex. The district court ordered Govil to pay additional disgorgement of approximately $5.8 million.

Govil raises two principal arguments on appeal. First, he contends that disgorgement was not authorized under 15 U.S.C. § 78u(d)(5) or 15 U.S.C. § 78u(d)(7). We agree. Our court recently held in *SEC v. Ahmed* that the disgorgement remedies available under §

78u(d)(5) and § 78u(d)(7) are limited by equitable principles. *See SEC v. Ahmed*, 72 F.4th 379, 396 (2d Cir. 2023) ("[W]e conclude that disgorgement under § 78u(d)(7) must comport with traditional equitable limitations as recognized in *Liu* [*v. SEC,* 140 S. Ct. 1936 (2020)]."). One of the equitable limitations identified in *Liu* is that disgorgement must be "awarded for victims." Because a defrauded investor is not a "victim" for equitable purposes if he suffered no pecuniary harm, the district court needed to determine that the investors Govil defrauded suffered pecuniary harm before awarding disgorgement. Even though *Ahmed* was decided after the district court ruled in this case, the district court abused its discretion in making the award without that predicate determination. Accordingly, we vacate the judgment of the district court and remand with instructions to determine whether the investors suffered pecuniary harm as a result of the fraud.

….

[I]

Disgorgement is a remedy first devised in the 1970s and rooted in the equity power. *See SEC v. Tex. Gulf Sulphur Co*., 446 F.2d 1301, 1307-08 (2d Cir. 1971) ("[T]he SEC may seek other than injunctive relief in order to effectuate the purposes of the [Exchange] Act, so long as such relief is remedial relief and is not a penalty assessment.") …

Despite its roots in the equity power, however, the disgorgement remedy as it developed in the courts prior to *Liu* "cross[ed] the bounds of traditional equity practice." So disgorgement prior to *Liu* was not an entirely equitable remedy, even if it had originated as one.

In 2002, Congress enacted § 78u(d)(5). The statute formally gave the SEC the power to request—and federal courts the power to grant—"any equitable relief" in an enforcement action so long as that relief was "appropriate or necessary for the benefit of investors." Confusion emerged fifteen years later when the Supreme Court decided *Kokesh v. SEC*, 581 U.S. 455 (2017). That case presented the question of whether disgorgement generally qualifies as a "penalty" for purposes of the statute of limitations found in 28 U.S.C. § 2462. The Court said yes, but in so holding clouded the legal basis for disgorgement in SEC enforcement actions. "Nothing in this opinion," the Court said, "should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context." The Court assumed—but did not decide—that our disgorgement jurisprudence dating back to *Texas Gulf Sulphur* was sound.

The Court resolved the confusion three years later in *Liu*. That case presented the question of whether the SEC may seek and federal courts may order "'disgorgement' in the first instance through [the court's] power to award 'equitable relief' under 15 U.S.C. § 78u(d)(5)." Construing the phrase "equitable relief," the Court held that "a disgorgement award that [1] does not exceed a wrongdoer's net profits and [2] is awarded for victims" constitutes "equitable relief permissible under § 78u(d)(5)." The *Liu* Court observed that the disgorgement jurisprudence of the federal courts of appeals had "test[ed]" the bounds of equity by, among other things, "ordering the proceeds of fraud to be deposited in Treasury funds instead of disbursing them to victims."

Six months after *Liu*, Congress enacted several amendments to § 78u(d) (hereinafter the "2021 Amendments" [or NDAA]) …. Most relevant here, Congress enacted § 78u(d)(7), which gives the SEC the power to "seek" and federal courts the power to "order" the remedy of "disgorgement."

In *Ahmed*, we considered whether § 78u(d)(7) restored our disgorgement framework as it stood prior to *Liu* or instead authorized a remedy consistent with the limitations described in *Liu*. We decided that it did the latter. We held that "*Liu's* equitable limitations on disgorgement survive the NDAA" and there "[w]e read 'disgorgement' in § 78u(d)(7) to refer to equitable disgorgement as recognized in *Liu*." In short, "disgorgement under § 78u(d)(7) must comport with traditional equitable limitations as recognized in *Liu*." Based on our precedent, disgorgement under both § 78u(d)(5) and § 78u(d)(7) are constrained by *Liu*. For that reason, Govil's suggestion that § 78u(d)(7) might separately authorize disgorgement is foreclosed. The express addition of 'disgorgement' as a remedy specified under § 78u(d)(7) is … a 'belt and suspenders' clarification that equitable disgorgement is [§ 78u(d)(5)'s] reference to the equity power, yet the 2021 Amendments conspicuously distinguish between disgorgement and equity.

In *Ahmed*, however, our court concluded that § 78u(d)(7)'s use of the word disgorgement—along with a cross reference to "unjust enrichment" in § 78u(d)(3)(A)(ii)—refers to a "remedy grounded in equity" and so must "be deemed to contain the limitations upon its availability that equity typically imposes."

We also said that § 78u(d)(7) should be read to enact *Liu* because that reading "clarifie[s] some aspects of th[e] uncertainty" about the statute. We explained that it had been uncertain before *Liu* and the 2021 Amendments whether disgorgement qualified as equitable relief under § 78u(d)(5). We further explained that "the applicable statute of limitations" was uncertain before *Kokesh*. "[T]he authorization of a ten-year statute of limitations under § 78u(d)(8)(A)(ii) is best understood as expressly overruling *Kokesh's* five-year statute of limitations as to certain securities violations. So we conclude that disgorgement under § 78u(d)(7) must comport with traditional equitable limitations as recognized in *Liu*."

We are bound to apply *Ahmed* in this case. *See Glob. Reinsurance Corp. of Am. v. Century Indem. Co*., 22 F.4th 83, 100-01 (2d Cir 2021) ("[G]enerally a decision of a panel of this Court is binding unless and until it is overruled by the Court *en banc* or by the Supreme Court."). Under *Ahmed*, the disgorgement analysis under § 78u(d)(5) and § 78u(d)(7) are the same in that both depend on *Liu*.

[II]

Liu does not authorize disgorgement on these facts, so we vacate the judgment of the district court. Govil's argument proceeds in three steps. First, he says that disgorgement under § 78u(d)(5) must be "equitable relief." That premise is not disputed. Second, the Court in *Liu* explained that disgorgement is "equitable relief" when it "does not exceed a wrongdoer's net profits" and "is awarded for victims." This premise, too, is undisputed. Third, the district court's opinion in this case indicated that the proceeds of his disgorgement would be directed to the investors defrauded in the Cemtrex offerings, yet the district court did not find that those investors suffered pecuniary harm. That means that the investors might not be victims. Only this third step is disputed. We agree with Govil's argument and hold that a "victim" for purposes of § 78u(d)(5) is one who suffers pecuniary harm from the securities fraud.

The Supreme Court's opinion in *Liu* did not explain straightforwardly what a "victim" is for the purpose of awarding "equitable relief." But the Court provided guiding principles. For example, the Court explained that a remedy resides in the "heartland of equity" when it "restores the status quo." If we were to understand "victim" as including defrauded investors who suffered no pecuniary harm—and thus to allow those investors to receive the proceeds of disgorgement—we would not be restoring the status quo for those investors. We would be conferring a windfall on those who received the benefit of the bargain.

That is why the *Liu* Court emphasized that such an equitable remedy is about "*return[ing]* the funds to victims." The *return* of funds presupposes pecuniary harm. Funds cannot be returned if there was no deprivation in the first place.

We again see the centrality of pecuniary harm to victimhood when we consider the other profit-stripping remedies that the *Liu* Court discussed: constructive trust and accounting. The Court explained that the constructive trust remedy "converted the wrongdoer, who in many cases was an infringer, into a trustee, as to those profits, for the owner of the [property] which he infringes." For example, a patent holder has a legal claim to the profits derived from the patent. When the infringer misappropriates those profits, "compensation [is] due from the infringer to the pantentee." Prior to bringing an action in equity, the patent holder was deprived of compensation and thereby suffered pecuniary harm....

Because the district court found the investors were victims without determining whether those investors suffered pecuniary harm, the district court "based its ruling on an erroneous view of the law" and thereby abused its discretion.

[III]

The SEC's counterarguments are unavailing. First, the SEC argues that pecuniary harm is not a prerequisite for disgorgement under § 78u(d)(5) because there is no requirement to "quantify the dollar value of the harm to particular investors in order to obtain disgorgement." The SEC explains that this is because disgorgement is "measured by" the wrongful gain obtained by the defendant rather than by the loss to the investor. That correctly describes how to calculate disgorgement. But this description does not address the separate question of when disgorgement qualifies as "equitable relief" and is authorized by § 78u(d)(5) and § 78u(d)(7) in the first place. As the Supreme Court explained in *Liu,* whether disgorgement is equitable relief turns in part on whether it is "awarded for victims." Whether an investor has suffered pecuniary harm—bringing the investor into the category of victims—is a different issue from how to quantify the ill-gotten gains.

….

In sum, § 78u(d)(5) and § 78u(d)(7) authorize disgorgement that is "equitable relief." "Equitable relief" requires that the relief be "awarded for victims, and that in turn requires a finding of pecuniary harm. The district court did not make that predicate finding and therefore abused its discretion. We vacate the judgment and remand with instructions to make a factual determination as to pecuniary harm.

[IV]

Govil's second argument on appeal is that the district court erred in calculating the disgorgement award. He contends that—even accepting that $7.3 million is the correct amount of disgorgement overall—he already "returned a substantial value to Cemtrex when he relinquished all of his shares in the company." In other words, Govil maintains that he has already been divested of some amount of his ill-gotten gains and the disgorgement order should be correspondingly reduced. We agree. As a result, if on remand the district court determines that disgorgement is authorized, the district court must undertake a valuation of the surrendered securities and offset the disgorgement award by that amount.

The remedy of disgorgement aims to "force a defendant to give up the amount by which he was unjustly enriched." … The district court erred, however, when it concluded that the securities surrendered to Cemtrex as part of the Settlement did not constitute "fair compensation" to a wronged party.

The securities surrendered were such compensation. Although some of the shares were of uncertain value, those shares certainly had value in Govil's hands. As part of the Settlement, Govil tendered to Cemtrex 469,949 shares of Series 1 Preferred Stock. As all parties admit, Series 1 Preferred Shares trade publicly and are relatively liquid. In principle Govil could have sold his Series 1 Preferred Shares on the open market and tendered the proceeds to Cemtrex, which everyone agrees would be "fair compensation" for the purpose of disgorgement. It is true that, had Govil sold that volume of shares on the market at once, the price would have declined. But the relevant inquiry at this point is not the value of the shares; it is whether the shares had value at all.

That Govil returned property of value in the form of Series 1 Preferred shares is bolstered by the observation that the shares had value *even in Cemtrex's hands*. The Cemtrex board canceled those shares, but it did not need to do so. Cemtrex could have traded the shares for consideration. And even if Cemtrex simply held or canceled the shares, Cemtrex still would have received value because the 10 percent dividend on the Series 1 Preferred shares would not be payable when the shares were no longer outstanding. In sum, the Series 1 Preferred shares had value even in Cemtrex's hands. That supports the conclusion Govil was stripped of ill-gotten gains when he relinquished his interest in the Series 1 Preferred shares.

The Settlement also specified that Govil would return his Series A Preferred and Series C Preferred shares. While those shares did not trade publicly or pay a regular dividend, the shares nevertheless had value in Govil's hands. The principal benefit of the Series A Preferred and Series C Preferred shares is that the shares enabled the holder to control Cemtrex. Control of a company—even without a claim to the company's retained earnings—has value. That is why a "control premium" is often added to the valuation of shares that control a company. Indeed, the appraiser in this case added a control premium when valuing the Series A Preferred and Series C Preferred shares. While the accuracy of that valuation is a matter for the district court on remand, we cannot say based on the record before us that the control that came along with Govil's interest in those preferred shares was without value. We conclude that Govil gave compensation as part of the Settlement.

The only remaining question is whether surrender of the securities to Cemtrex constitutes a return to the "person wronged." The district court concluded that "the investors [were] victims of Govil's misconduct." It declined to say whether Cemtrex itself was a wronged party. The district court explained that the stock surrender did not provide value to the investors, so the stock surrender should not count against Govil's disgorgement amount. That conclusion was erroneous.

Even if the district court were correct that only the investors—not Cemtrex—were harmed, the Settlement nevertheless constituted compensation to the wronged party. As we have explained, the surrendered securities had value. When Govil surrendered the securities, the value of the securities was transferred to Cemtrex and thereby benefited Cemtrex investors. The district court embraced this theory as it applied to the promissory note and credited the note's value against the overall disgorgement amount. In so doing, the district court explained that "the funds from the promissory note will presumably be placed in [Cemtrex's] account and used for corporate expenses, [so] the original promise to the purchasers of the offerings will, in fact, be realized." That argument applies with equal force to the surrendered securities. The defrauded investors enjoyed the benefit of value transferred to the company in the same way that they enjoyed the benefit of the funds promised by the note.

We conclude that the district court erred in deciding not to offset the disgorgement award by the value of the surrendered securities. If the district court determines that the defrauded investors suffered pecuniary harm, which would mean that disgorgement is authorized, … the district court must value the surrendered securities and credit that value against the overall disgorgement award.

§ 15.04 SEC Administrative Enforcement Remedies

On page 977, add:

Axon Enterprise, Inc. v. Federal Trade Commission

Securities and Exchange Commission v. Cochran

United States Supreme Court
143 S. Ct. 890 (2023)

JUSTICE KAGAN delivered the opinion of the Court.

In each of these two cases, the respondent in an administrative enforcement action challenges the constitutional authority of the agency to proceed. Both respondents claim that the agencies' administrative law judges (ALJs) are insufficiently accountable to the President, in violation of separation-of-powers principles. And one respondent attacks as well the combination of prosecutorial and adjudicatory functions in a single agency. They maintain in essence that the agencies, as currently structured, are unconstitutional in much of their work.

Our task today is not to resolve those challenges; rather, it is to decide where they may be heard. The enforcement actions at issue were initiated in the Securities and Exchange Commission (SEC) and the Federal Trade Commission (FTC). Most objections to those Commissions' proceedings follow a well-trod path. As prescribed by statute, a party makes its claims first within the Commission itself, and then (if needed) in a federal court of appeals. The parties here, however, sidestepped that review scheme. Seeking to stop the administrative proceedings, they instead brought their claims in federal district court. The question presented is whether the district courts have jurisdiction to hear those suits—and so to resolve the parties' constitutional challenges to the Commissions' structure. The answer is yes. The ordinary statutory review scheme does not preclude a district court from entertaining these extraordinary claims.

I

Congress established the SEC to protect investors in securities markets and created the FTC to promote fair competition. The Commissions enforce, respectively, the Securities Exchange Act and the FTC Act (among other laws). Those Acts authorize the Commissions to address statutory violations either by bringing civil suits in federal district court or by instituting their own administrative proceedings.

When a Commission elects the latter option—as in these two cases—it typically delegates the initial adjudication to an ALJ. To foster independence, each Commission's ALJs are removable "only for good cause" as determined by the Merit Systems Protection Board (MSPB)—a separate agency whose members are themselves removable by the President only for cause, such as "neglect of duty" or "malfeasance." An ALJ assigned to hear an SEC or FTC enforcement action has authority, much like a regular trial judge, to resolve motions, hold a hearing, and then issue a decision.

A losing party may appeal the ALJ's ruling to the Commission; alternatively, the Commission may undertake review on its own initiative. Upon completion of internal review, the Commission enters a final decision. Or if no such review has occurred, the ALJ's ruling itself becomes the decision of the Commission.

The Exchange Act and FTC Act both provide for review of a final Commission decision in a court of appeals, rather than a district court….

The cases before us, though, did not take the above-described course. In each, the respondent in an administrative enforcement action sued in district court prior to an ALJ decision, seeking to enjoin the Commission's proceeding. Each suit charged that some fundamental aspect of the Commission's structure violates the Constitution; that the violation made the entire proceeding unlawful; and that being subjected to such an illegitimate proceeding causes legal injury (independent of any rulings the ALJ might make). Finally, each suit premised jurisdiction on district courts' ordinary federal-question authority—their power, under 28 U. S. C. §1331, to resolve "civil actions arising under the Constitution, laws, or treaties of the United States." …

II

A

A special statutory review scheme, this Court has recognized, may preclude district courts from exercising jurisdiction over challenges to federal agency action. District courts may ordinarily hear those challenges by way of 28 U. S. C. §1331's grant of jurisdiction for claims "arising under" federal law. Congress, though, may substitute for that district court authority an alternative scheme of review. Congress of course may do so explicitly, providing in so many words that district court jurisdiction will yield. But Congress also may do so implicitly, by specifying a different method to resolve claims about agency action. The method Congress typically chooses is the one used in both the Exchange Act and the FTC Act: review in a court of appeals following the agency's own review process. We have several times held that the creation of such a review scheme for agency action divests district courts of their ordinary jurisdiction over the covered cases…. The agency effectively fills in for the district court, with the court of appeals providing judicial review.

But a statutory review scheme of that kind does not necessarily extend to every claim concerning agency action. Our decision in *Thunder Basin* [510 U. S. 200 (1994)] made that point clear. After finding that Congress's creation of a "comprehensive review process" like the ones here ousted district courts of jurisdiction, the Court asked another question: whether the particular claims brought were "of the type Congress intended to be reviewed within this statutory structure." The Court identified three considerations designed to aid in that inquiry, commonly known now as the *Thunder Basin* factors. First, could precluding district court jurisdiction "foreclose all meaningful judicial review" of the claim? Next, is the claim "wholly collateral to [the] statute's review provisions"? And last, is the claim "outside the agency's expertise"? When the answer to all three questions is yes, "we presume that Congress does not intend to limit jurisdiction." But the same conclusion might follow if the factors point in different directions. The ultimate question is how best to understand what Congress has done—whether the statutory review scheme, though exclusive where it applies, reaches the claim in question. The first *Thunder Basin* factor recognizes that Congress rarely allows claims about agency action to escape effective judicial review. The second and third reflect in related ways the point of special review provisions—to give the agency a heightened role in the matters it customarily handles, and can apply distinctive knowledge to.

….

B

… Each of the three Thunder Basin factors signals that a district court has jurisdiction to adjudicate Axon's and Cochran's … sweeping constitutional claims.

We begin with the factor whose application here is least straightforward: whether preclusion of district court jurisdiction "could foreclose all meaningful judicial review." [Our decisions] make clear that adequate judicial review does not usually demand a district court's involvement. Review of agency action in a court of appeals can alone "meaningfully address[]" a party's claims.... Cochran and Axon are parties in ongoing SEC and FTC proceedings, and the statutes at issue provide for judicial review of SEC and FTC action. Under those statutes, Axon and Cochran can (eventually) obtain review of their constitutional claims through an appeal from an adverse agency action to a court of appeals….

Yet a problem remains, stemming from the interaction between the alleged injury and the timing of review…. The harm Axon and Cochran allege is "being subjected" to "unconstitutional agency authority"—a "proceeding by an unaccountable ALJ." That harm may sound a bit abstract; but this Court has made clear that it is "a here-and-now injury." And—here is the rub—it is impossible to remedy once the proceeding is over, which is when appellate review kicks in. Suppose a court of appeals agrees with Axon, on review of an adverse FTC decision, that ALJ-led proceedings violate the separation of powers. The court could of course vacate the FTC's order. But Axon's separation-of-powers claim is not about that order; indeed, Axon would have the same claim had it *won* before the agency. The claim, again, is about subjection to an illegitimate proceeding, led by an illegitimate decisionmaker. And as to that grievance, the court of appeals can do nothing: A proceeding that has already happened cannot be undone. Judicial review of Axon's (and Cochran's) structural constitutional claims would come too late to be meaningful.

The limits of that conclusion are important to emphasize. The Government, in disputing our position, notes that many review schemes—involving not only agency action but also civil and criminal litigation—require parties to wait before appealing, even when doing so subjects them to "significant burdens." That is true, and will remain so: Nothing we say today portends newfound enthusiasm for interlocutory review…. We have made clear, just as the Government says, that "the expense and disruption" of "protracted adjudicatory proceedings" on a claim do not justify immediate review. What makes the difference here is the nature of the claims and accompanying harms that the parties are asserting. Again, Axon and Cochran protest the "here-and-now" injury of subjection to an unconstitutionally structured decisionmaking process. And more, subjection to that process irrespective of its outcome, or of other decisions made within it. … [Here,] Axon and Cochran will lose their rights not to undergo the complained-of agency proceedings if they cannot assert those rights until the proceedings are over.

The collateralism factor favors Axon and Cochran for much the same reason—because they are challenging the Commissions' power to proceed at all, rather than actions taken in the agency proceedings…. Here, both parties object to the Commission's power generally, not to anything particular about how that power was wielded. The parties' separation-of-powers claims do not relate to the subject of the enforcement actions—in the one case auditing practices, in the other a business merger. Nor do the parties' claims address the sorts of procedural or evidentiary matters an agency often resolves on its way to a merits decision. The claims, in sum, have nothing to do with the enforcement-related matters the Commissions "regularly adjudicate[]"—and nothing to do with those they would adjudicate in assessing the charges against Axon and Cochran. Because that is so, the parties' claims are "'collateral' to any Commission orders or rules from which review might be sought."

....

Third and finally, Cochran's and Axon's claims are "outside the [Commissions'] expertise." On that issue, *Free Enterprise Fund* [561 U. S. 477 (2010)] could hardly be clearer. Claims that tenure protections violate Article II, the Court there determined, raise "standard questions of administrative" and constitutional law, detached from "considerations of agency policy." That statement covers Axon's and Cochran's claims that ALJs are too far insulated from the President's supervision. And Axon's constitutional challenge to the combination of prosecutorial and adjudicative functions is of a piece—similarly distant from the FTC's "competence and expertise." The Commission knows a good deal about competition policy, but nothing special about the separation of powers....

....

All three *Thunder Basin* factors thus point in the same direction—toward allowing district court review of Axon's and Cochran's claims that the structure, or even existence, of an agency violates the Constitution. For the reasons given above, those claims cannot receive meaningful judicial review through the FTC Act or [Securities] Exchange Act. They are collateral to any decisions the Commissions could make in individual enforcement proceedings. And they fall outside the Commissions' sphere of expertise. Our conclusion follows: The claims are not "of the type" the statutory review schemes reach. A district court can therefore review them.

Securities and Exchange Commission v. Jarkesy

United States Supreme Court
603 U.S. 109 (2024)

CHIEF JUSTICE ROBERTS delivered the opinion of the Court.

In 2013, the Securities and Exchange Commission initiated an enforcement action against respondents George Jarkesy, Jr. and Patriot28, LLC seeking civil penalties for alleged securities fraud. The SEC chose to adjudicate the matter in-house before one of its administrative law judges, rather than in federal court where respondents could have proceeded before a jury. We consider whether the Seventh Amendment permits the SEC to compel respondents to defend themselves before the agency rather than before a jury in federal court.

I.

A.

In the aftermath of the Wall Street Crash of 1929, Congress passed a suite of laws designed to combat securities fraud and increase market transparency. Three such statutes are relevant here: The Securities Act of 1933, The Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. These Acts respectively govern the registration of securities, the trading of securities, and the activities of investment advisers. Their protections are mutually reinforcing and often overlap. Although each regulates different aspects of the securities markets, their pertinent provisions—collectively referred to by regulators as "the antifraud provisions"—target the same basic behavior: misrepresenting or concealing material facts.

The three antifraud provisions are Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act, and Section 206 of the Investment Advisers Act. Section 17(a) prohibits regulated individuals from "obtain[ing] money or property by means of any untrue statement of a material fact," as well as causing certain omissions of material fact. As implemented by Rule 10b-5, Section 10(b) prohibits using "any device, scheme, or artifice to defraud," making "untrue statement[s] of … material fact," causing certain material omissions, and "engag[ing] in any act … which operates or would operated as a fraud." And finally, Section 206(b) [of the Investment Advisers Act], as implemented by Rule 206(4)-8, prohibits investment advisers from making "any untrue statement of a material fact" or engaging in "fraudulent, deceptive, or manipulative" acts with respect to investors or prospective investors.

To enforce these Acts, Congress created the SEC. The SEC may bring an enforcement action in one of two forums. First, the Commission can adjudicate the matter itself. Alternatively, it can file a suit in federal court. The SEC's choice of forum dictates two aspects of the litigation: The procedural protections enjoyed by the defendant and the remedies available to the SEC.

Procedurally, these forums differ in who presides and makes legal determinations, what evidentiary and discovery rules apply, and who finds facts. Most pertinently, in federal court a jury finds the facts depending on the nature of the claim. In addition, a life-tenured, salary-protected Article III judge presides, and the litigation is governed by the Federal Rules of Evidence and the ordinary rules of discovery.

Conversely, when the SEC adjudicates the matter in-house, there are no juries. Instead, the Commission presides and finds facts while its Division of Enforcement prosecutes the case. The Commission may also delegate its role as judge and factfinder to one of its members or to an administrative law judge (ALJ) that it employs. In these proceedings, the Commission or its delegee decides discovery disputes and the SEC's Rules of Practice govern. The Commission or its delegee also determines the scope and form of permissible evidence and may admit hearsay and other testimony that would be inadmissible in federal court.

When a Commission member or an ALJ presides, the full Commission can review that official's findings and conclusions, but it is not obligated to do so. Judicial review also is available once the proceedings have concluded. But such review is deferential. By law, a reviewing court must treat the agency's factual findings as "conclusive" if sufficiently supported by the record, even when they rest on evidence that could not have been admitted in federal court.

The remedy at issue in this case, civil penalties, also originally depended upon the forum chosen by the SEC. Except in cases against registered entities, the SEC could obtain civil penalties only in federal court. That is no longer so. In 2010, Congress passed the Dodd-Frank Act. That Act "made the SEC's authority in administrative penalty proceedings coextensive with its authority to seek penalties in Federal court." H.R. Rep. No. 111-687, p.78 (2010). In other words, the SEC may now seek civil penalties in federal court, or it may impose them through its own in-house proceedings….

Civil penalties rank among the SEC's most potent enforcement tools…. And the SEC may levy these penalties even when no investor has actually suffered financial loss….

B.

Shortly after passage of the Dodd-Frank Act, the SEC began investigating Jarkesy and Patriot28 for securities fraud. Between 2007 and 2010, Jarkesy launched two investment funds, raising about $24 million from 120 "accredited" investors—a class of investors that includes, for example, financial institutions, certain investment professionals, and high net worth individuals. Patriot28, which Jarkesy managed, served as the funds' investment adviser. According to the SEC, Jarkesy and Patriot28 misled investors in at least three ways: (1) by misrepresenting the investment strategies that Jarkesy and Patriot28 employed, (2) by lying about the identity of the funds' auditor and prime broker, and (3) by inflating the funds' claimed value so that Jarkesy and Patriot28 could collect larger management fees. The SEC initiated an enforcement action, contending that these actions violated the antifraud provisions of the Securities Act, the Securities Exchange Act, and Investment Advisers Act, and sought civil penalties and other remedies.

Relying on the new authority conferred by the Dodd-Frank Act, the SEC opted to adjudicate the matter itself rather than in federal court. In 2014, the presiding ALJ issued an initial decision. The SEC reviewed the decision and then released its final order in 2020. The final order levied a civil penalty of $300,000 against Jarkesy and Patriot28, directed them to cease and desist committing or causing violations of the antifraud provisions, ordered Patriot28 to disgorge earnings, and prohibited Jarkesy from participating in the securities industry and in offerings of penny stocks.

Jarkesy and Patriot28 petitioned for judicial review. A divided panel of the Fifth Circuit granted their petition and vacated the final order…. [T]he panel held that the [SEC's] decision to adjudicate the matter in-house violated Jarkesy's and Patriot28's Seventh Amendment right to a jury trial…. The panel concluded … that the case should have been brought in federal court, where a jury could have found the facts pertinent to the defendants' fraud liability. Based on this Seventh Amendment violation, the panel vacated the final order….

II.

This case poses a straightforward question: whether the Seventh Amendment entitles a defendant to a jury trial when the SEC seeks civil penalties against him for securities fraud…. The threshold issue is whether this action implicates the Seventh Amendment. It does. The SEC's antifraud provisions replicate common law fraud, and it is well established that common law claims must be heard by a jury.

Since this case does implicate the Seventh Amendment, we next consider whether the "public rights" exception to Article III jurisdiction applies. This exception has been held to permit Congress to assign certain matters to agencies for adjudication even though such proceedings would not afford the right to a jury trial. The exception does not apply here because the present action does not fall within any of the distinctive areas involving governmental prerogatives where the Court has concluded that a matter may be resolved outside of an Article III court, without a jury. The Seventh Amendment therefore applies and a jury is required….

A.

We first explain why this action implicates the Seventh Amendment.

1

The right to trial by jury is "of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right" has always been and "should be scrutinized with the utmost care."…

2

By its text the Seventh Amendment guarantees that in "suits at common law … the right of trial by jury shall be preserved." In construing this language, we have noted that the right is not limited to the "common-law forms of action recognized" when the Seventh Amendment was ratified. … The Amendment therefore "embraces all suits which are not of equity or admiralty jurisdiction, whatever may be the peculiar form which they may assume."

The Seventh Amendment extends to a particular statutory claim if the claim is "legal in nature." … [W]hether that claim is statutory is immaterial to this analysis….

In this case, the remedy is all but dispositive. For respondents' alleged fraud, the SEC seeks civil penalties, a form of monetary relief. While monetary relief can be legal or equitable, money damages are the prototypical common law remedy. What determines whether a monetary remedy is legal is if it is designed to punish or deter the wrongdoer, or, on the other hand, solely to "restore the status quo." As we have previously explained, "a civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment." And while courts of equity could order a defendant to return unjustly obtained funds, only courts of law issued monetary penalties to "punish culpable individuals." Applying these principles, we have recognized that "civil penalties are a type of remedy at common law that could be enforced in courts of law." The same is true here.

To start, the Securities and exchange Commission and the Investment Advisers Act condition the *availability* of civil penalties on six statutory factors: (1) whether the alleged misconduct involved fraud, deceit, manipulation, or deliberate or reckless disregard for regulatory requirements, (2) whether it caused harm, (3) whether it resulted in unjust enrichment, accounting for any restitution made, (4) whether the defendant had previously violated securities laws or regulations, or had previously committed certain crimes, (5) the need for deterrence, and (6) other "matters as justice may require." §§ 78u-2(c), 80b-3(i)(3). Of course, several [of these statutory factors] concern culpability, deterrence, and recidivism. Because they tie the availability of civil penalties to the perceived need to punish the defendant rather than to restore the victim, such considerations are legal rather than equitable.

The same is true of the criteria that determine the *size* of the available remedy. The Securities Act, the Securities Exchange Act, and the Investment Advisers Act establish three "tiers" of civil penalties. See §§ 77h-1(g)(2), 78u-2(b), 80b-3(i)(2). Violating a federal securities law or regulation exposes a defendant to a first tier penalty. A second tier penalty may be ordered if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard for regulatory requirements. Finally, if those acts also resulted in substantial gains to the defendant or losses to another, or created a "significant risk" of the latter, the defendant is subject to a third tier penalty. Each successive tier authorizes a larger monetary sanction.

Like the considerations that determine the availability of civil penalties in the first place, the criteria that divide these tiers are also legal in nature. Each tier conditions the available penalty on the culpability of the defendant and the need for deterrence, not the size of the harm that must be remedied. Indeed, showing that a victim suffered harm is not even required to advance a defendant from one tier to the next. Since nothing in this analysis turns on restoring the status quo, these factors show that these civil penalties are designed to be punitive.

The final proof that this remedy is punitive is that the SEC is not obligated to return any money to victims. Although the SEC can choose to compensate injured shareholders from the civil penalties it collects, it admits that it is not required to do so. Such a penalty by definition does not restore the status quo and can make no pretense of being equitable.

In sum, the 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.

The close relationship between the causes of action in this case and common law fraud confirms that conclusion. Both target the same basic conduct: misrepresenting or concealing material facts…. That is no accident. Congress deliberated used "fraud" and other common law terms of art in the Securities Act, the Securities Exchange Act, and the Investment Advisers Act. In so doing, Congress incorporated prohibitions from common law fraud into federal securities law. The SEC has followed suit in rulemakings. Rule 10b-5, for example, prohibits "any device, scheme, or artifice to defraud," and "engag[ing] in any act … which operates or would operate as a fraud."

Congress's decision to draw upon common law fraud created an enduring link between federal securities fraud and its common law "ancestor." Our precedents therefore often consider common law fraud principles when interpreting federal securities law….

That is not to say that federal securities fraud and common law fraud are identical. In some respects, federal securities fraud is narrower. For example, federal securities law does not "convert every common-law fraud that happens to involve securities into a violation. *SEC v. Zandford,* 535 U.S. 813, 820 (2002). It only targets certain subject matter and certain disclosures. In other respects, federal securities fraud is broader. For example, federal securities fraud employs the burden of proof typical in civil cases, while its common law analogue traditionally used a more stringent standard. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 387-390 (1983). Courts have also not typically interpreted federal securities fraud to require a showing of harm to be actionable by the SEC…. Nevertheless, the close relationship between federal securities fraud and common law fraud confirms that this action is "legal in nature." …

B.

Although the claims at issue here implicate the Seventh Amendment, the Government and the dissent argue that a jury trial is not required because the "public rights" exception applies. Under this exception, Congress may assign the matter for decision to an agency without a jury, consistent with the Seventh Amendment. But this case does not fall within the exception, so Congress may not avoid a jury trial by preventing the case from being heard before an Article III tribunal….

… [O]ur precedent has recognized a class of cases concerning what we have called "public rights." Such matters "historically could have been determined exclusively by the executive and legislative branches," even when they were "presented in such form that the judicial power was capable of acting on them." In contrast to common law claims, no involvement by an Article III court in the initial adjudication is necessary is such a case….

… [T]his Court has typically evaluated the legal basis for the assertion of the doctrine with care. The public rights exception is, after all, an *exception*. It has no textual basis in the Constitution and must therefore derive instead from background legal principles…. Without such close attention to the basis for each asserted application of the doctrine, the exception would swallow the rule.

From the beginning we have emphasized one point: "To avoid misconstruction upon so grave a subject, we think it proper to state that we do not consider Congress can … withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty." We have never embraced the proposition that "practical" considerations alone can justify extending the scope of the public rights exception to such matters….

….

… [T]he SEC contends the public rights exception applies in this case because Congress created "new statutory obligations, imposed civil penalties for their violation, and then committed to an administrative agency the function of deciding whether a violation had occurred."

The [Court's precedent] already does away with much of the SEC's argument. Congress cannot "conjure away the Seventh Amendment by mandating that traditional legal claims be … taken to an administrative tribunal." Nor does the fact that the SEC action "originated in a newly fashioned regulatory scheme" permit Congress to siphon this action away from an Article III court…. Again, if the action resembles a traditional legal claim, its statutory origins are not dispositive.

The SEC's sole remaining basis … is that the Government is the party prosecuting this action…. Again, what matters is the substance of the suit, not where it is brought, who brings it, or how it is labeled. The object of this SEC action is to regulate transactions between private individuals interacting in a pre-existing market. To do so, the Government has created claims whose causes of action are modeled on common law fraud and that provide a type of remedy available only in law courts. This is a common law suit in all but name. And such suits typically must be adjudicated in Article III courts.

….

***

A defendant facing a fraud suit has the right to be tried by a jury of his peers before a neutral adjudicator. Rather than recognize that right, the dissent would permit Congress to concentrate the roles of prosecutor, judge, and jury in the hands of the Executive Branch. That is the very opposite of the separation of powers that the Constitution demands. Jarkesy and Patriot28 are entitled to a jury trial in an Article III court….

It is so ordered.

JUSTICE GORSUCH, with whom JUSTICE THOMAS joins, concurring.

The Court decides a single issue: Whether the Securities and Exchange Commission's use of in-house hearings to seek civil penalties violates the Seventh Amendment right to a jury trial. It does. As the Court details, the government has historically litigated suits of this sort before juries, and the Seventh Amendment requires no less.

….

In March 2013, the SEC's Commissioners approved charges against Mr. Jarkesy. The charges were serious: the agency accused him of defrauding investors. The relief the agency sought was serious, too: millions of dollars in civil penalties. For most of the SEC's 90-year existence, the Commission had to go to federal court to secure that kind of relief against someone like Mr. Jarkesy. Proceeding that way in this case hardly would have promised an easy ride. But it would have at least guaranteed Mr. Jarkesy a jury, an independent judge, and traditional procedures designed to ensure that anyone caught up in our judicial system receives due process.

In 2010, however, all that changed. With the passage of the Dodd-Frank Act, Congress gave the SEC an alternative to court proceedings. Now, the agency could funnel cases like Mr. Jarkesy's through its own "adjudicatory" system. That is the route the SEC chose when it filed charges against Mr. Jarkesy.

There is little mystery why. The new law gave the SEC's Commissioners—the same officials who authorized the suit against Mr. Jarkesy—the power to preside over his case themselves and issue judgment. To be sure, the Commissioners opted, as they often do, to send Mr. Jarkesy's case in the first instance to an "administrative law judge" (ALJ). But the title "judge" in this context is not quite what it might seem. Yes, ALJs enjoy some measure of independence as a matter of regulation and statute from the lawyers who pursue charges on behalf of the agency. But they remain servants of the same master—the very agency tasked with prosecuting individuals like Mr. Jarkesy. This close relationship, as others have long recognized, can make it "extremely difficult, if not impossible, for [the ALJ] to convey the image of being an impartial fact finder." … And with a jury out of the picture, the ALJ decides not just the law but the facts as well.

Going in, then, the odds were stacked against Mr. Jarkesy. The numbers confirm as much: According to one report, during the period under study the SEC won about 90% of its contested in-house proceedings compared to 69% of its cases in court. D. Thornley & J. Blount, SEC In-House Tribunals: A Call for Reform, 62 Vill. L. Rev. 261, 286 (2017)….

The shift from a court to an ALJ didn't just deprive Mr. Jarkesy of the right to an independent judge and a jury. He also lost many of the procedural protections our courts supply in cases where a person's life, liberty, or property is at stake. After an agency files a civil complaint in court, a defendant may obtain from the SEC a large swathe of documents relevant to the lawsuit. See Fed. Rule Civ. Proc. 26(b)(1). He may subpoena third parties for testimony and documents and take 10 oral depositions—more with the court's permission. A court has flexibility, as well, to set deadlines for discovery and other matters to meet the needs of the case. And come trial, the Federal Rules of Evidence apply, meaning that hearsay is generally inadmissible and witnesses must usually testify in person, subject to cross-examination. See Fed. Rule Evid. 802.

Things look very different in agency proceedings. The SEC has a responsibility to provide "documents that contain material exculpatory evidence." 17 CFR § 201.230(b)(3). But the defendant enjoys no general right to discovery. Though ALJs enjoy the power to issue subpoenas on the request of litigants like Mr. Jarkesy, they "often decline to issue [them] or choose to significantly narrow their scope." G. Mark, SEC and CFTC Administrative Proceedings, 19 U. Pa. Const. L. 45, 68 (2016). Oral depositions are capped at fine, with another two if the ALJ grants permission. In some cases, an administrative trial must take place as soon as 1 month after service of the charges, and that hearing must follow within 10 months in even the most complex matters. The rules of evidence, including their prohibition against hearsay, do not apply with the same rigor they do in court. For that reason, live testimony often gives way to "investigative testimony"—that is, a "sworn statement" taken outside the presence of the defendant or his counsel.

How did all this play out in Mr. Jarkesy's case? Accompanying its charges, the SEC disclosed 700 gigabytes of data—equivalent to between 15 and 25 million pages of information—it had collected during its investigation. Over Mr. Jarkesy's protest that it would take "two lawyers or paralegals working twelve-hour days over four decades to review," the ALJ gave Mr. Jarkesy 10 months to prepare for his hearing. Then, after conducting that hearing, the ALJ turned around and obtained from the Commission "an extension of six months to file [her] initial decision." The reason? The "size and complexity of the proceeding." When that decision eventually arrived seven months after the hearing, the ALJ agreed with the SEC on every charge.

Mr. Jarkesy had the right to appeal to the Commission, but appeals to that politically accountable body (again, the same body that approved the charges) tend to go about as one might expect. The Commission may decline to review the ALJ's decision. If it chooses to hear the case, it may *increase* the penalty imposed on the defendant. A defendant unhappy with the result can seek further review in court, though that process will take more time and money, too. Nor will he find a jury there, only a judge who must follow the agency's findings if they are supported by "more than a mere scintilla" of evidence….

Mr. Jarkesy filed an appeal anyway. The Commission agreed to review the ALJ's decision. It then afforded itself the better part of six years to issue an opinion. And, after all that, it largely agreed with the ALJ….

….

People like Mr. Jarkesy may be unpopular. Perhaps even rightly so: The acts he allegedly committed may warrant serious sanctions. But that should not obscure what is at stake in his case or others like it. While incursions on old rights may begin in cases against the unpopular, they rarely end there. The authority the government seeks (and the dissent would award in this case)—to penalize citizens without a jury, without an independent judge, and under procedures foreign to our courts—certainly contains no such limits. That is why the Constitution built "high walls and clear distinctions" to safeguard individual liberty…. Ones that ensure even the least popular among us has an independent judge and a jury of his peers resolve his case under procedures designed to ensure a fair trial in a fair forum. In reaffirming all this today, the Court hardly leaves the SEC without ample powers and recourse. The agency is free to pursue all of its charges against Mr. Jarkesy. And it is free to pursue them exactly as it had always done until 2010: In a court, before a judge, and with a jury….

JUSTICE SOTOMAYOR, with whom JUSTICE KAGAN and JUSTICE JACKSON join, dissenting.

Throughout our Nation's history, Congress has authorized agency adjudicators to find violations of statutory obligations and award civil penalties to the Government as an injured sovereign. The Constitution, this Court has said, does not require these civil-penalty claims belonging to the Government to be tried before a jury in federal district court. Congress can instead assign them to any agency for initial adjudication, subject to judicial review. This Court has blessed this practice repeatedly …. Unsurprisingly, Congress has taken this Court's word at face value. It has enacted more than 200 statutes authorizing dozens of agencies to impose civil penalties for violations of statutory obligations. Congress had no reason to anticipate the chaos today's majority would unleash after all these years.

Today, for the very first time, this Court holds that Congress violated the Constitution by authorizing a federal agency to adjudicate a statutory right that inheres in the Government in its sovereign capacity, also known as a public right. According to the majority, the Constitution requires the Government to seek civil penalties for federal securities fraud before a jury in federal court. The nature of the remedy is, in the majority's view, virtually dispositive. That is plainly wrong. This Court has held, without exception, that Congress has broad latitude to create statutory obligations that entitle the Government to civil penalties, and then to assign their enforcement outside the regular courts of law where there are no juries.

Beyond the majority's legal errors, its ruling reveals a far more fundamental problem: This Court's repeated failure to appreciate that its decisions can threaten the separation of powers. Here, that threat comes from the Court's mistaken conclusion that Congress cannot assign a certain public-rights matter for initial adjudication to the Executive because it must come only to the Judiciary.

The majority today upends longstanding precedent and the established practice of its coequal partners in our tripartite system of Government. Because the Court fails to act as a neutral umpire when it rewrites established rules in the manner it does today, I respectfully dissent.

….

The majority affirms the Fifth Circuit's decision, notwithstanding the mountain of precedent against it. A faithful application of our precedent would have led, inexorably, to upholding the statutory scheme that Congress enacted for the SEC's in-house adjudication of federal securities claims.

….

… [I]n every case where the Government has acted in its sovereign capacity to enforce a new statutory obligation through the administrative imposition of civil penalties or fines, this Court, without exception, has sustained the statutory scheme authorizing this enforcement ….

A unanimous Court made this exact point nearly half a century ago in *Atlas Roofing* [*Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442 (1977)]. That was the last time this Court considered a public-rights case where the constitutionality of an in-house adjudication of statutory claims brought by the Government was at issue. That case presented the same question as this one: Whether the Seventh Amendment permits Congress to commit the adjudication of a new cause of action for civil penalties to an administrative agency. The Court said it did….

[In *Atlas Roofing*,] [t]his Court upheld OSHA's statutory scheme. It relied on the long history of public-rights cases endorsing Congress's now-settled practice of assigning the Government's rights to civil penalties for violations of a statutory obligation to in-house adjudication in the first instance. In light of this history of our cases, the Court concluded that, where Congress "creates a new cause of action and remedies therefor, unknown to the common law," it is free to "place their enforcement in a tribunal supplying speedy and expert resolutions of the issues involved." … "That is the case even if the Seventh Amendment would have required a jury where the adjudication of those rights is assigned to a federal court of law." …

The "new rule" and "legally unsound principle" that the majority accuses this dissent of "unfurl[ing]" today, is the one that this Court declared "settled judicial construction from the beginning": "The Government could commit the enforcement of statutes and the imposition and collection of fines … for administrative enforcement, without judicial trials," even if the same action would have required a jury trial if committed to an Article III court….

….

It should be obvious by now how this case should have been resolved under a faithful and straightforward application of *Atlas Roofing* and a long line of this Court's precedents. The constitutional question is indistinguishable. The majority instead wishes away *Atlas Roofing* by burying it at the end of its opinion and minimizing the unbroken line of cases on which *Atlas Roofing* relied. That approach to precedent significantly undermines this Court's commitment to *stare decisis* and the rule of law.

….

… [B]oth here and in *Atlas Roofing*, Congress empowered the Government to institute administrative enforcement proceedings to adjudicate potential violations of federal law and impose civil penalties on a private party for those violations, all while making the final agency decision subject to judicial review. In bringing a securities claim, the SEC seeks redress for a "violation" that "is committed against the United States rather than an aggrieved individual," which "is why, for example, a securities-enforcement action may proceed even if victims do not support or are not parties to the prosecution." Put differently, the SEC seeks to "remedy harm to the public at large" for violation of the Government's rights. The Government likewise seeks to remedy a public harm when it enforces OSHA's prohibition of unsafe working conditions.

Ultimately, both cases arise between the Government and others in connection with the performance of the Government's constitutional functions, and involve the Government acting in its sovereign capacity to bring a statutory claim on behalf of the United States in order to vindicate the public interest. They both involve … "new causes of action, and remedies therefor, unknown to the common law." Neither Article III nor the Seventh Amendment prohibits Congress from assigning the enforcement of these new Government rights to civil penalties to non-Article III adjudicators, and thus "supplying speedy and expert resolutions of the issues involved." In a world where precedent means something this should end the case, Yet here it does not.

….

… [This Court's precedents] could not have been clearer on this point: Congress can assign the enforcement of a statutory obligation for in-house adjudication to executive officials….

….

A faithful and straightforward application of this Court's longstanding precedent should have resolved this case. Faither "adherence to precedent is a foundation stone of the rule of law." … It allows courts to function, and be perceived as courts, and not as political entities. "It promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." …

Today's decision disregards these foundational principles. Time will tell what is left of the public-rights doctrine. Less uncertain, however, are the momentous consequences that flow from the majority's insistence that the Government's rights to civil penalties must now be tried before a jury in federal court. The majority's decision, which strikes down the SEC's in-house adjudication of civil-penalty claims on the ground that such claims are legal in nature and entitle respondents to a jury trial, effects a seismic shift in this Court's jurisprudence….

Following this Court's precedents and the recommendation of the Administrative Conference of the United States, Congress has enacted countless new statutes in the past 50 years that have empowered federal agencies to impose civil penalties for statutory violations….

Similarly, there are, at the very least, more than two dozen agencies that can impose civil penalties in administrative proceedings….

[Because of the Court's holding today,] … the constitutionality of hundreds of statutes may now be in peril, and dozens of agencies could be stripped of their power to enforce laws enacted by Congress…. Today's decision is a massive sea change. Litigants seeking further dismantling of the "administrative state" have reason to rejoice in their win today, but those of us who cherish the rule of law have nothing to celebrate.

….

There are good reasons for Congress to set up a scheme like the SEC's. It may yield important benefits over jury trials in federal court, such as greater efficiency and expertise, transparency and reasoned decisionmaking, as well as uniformity, predictability, and greater political accountability. Others may believe those benefits are overstated, and that a federal jury is a better check on government overreach….

The Court's job is not to decide who wins this debate. These are policy considerations for Congress in exercising its legislative judgment and constitutional authority to decide how to tackle today's problems. It is the electorate, and the Executive to some degree, not this Court, that can and should provide a check on the wisdom of those judgments.

Make no mistake: Today's decision is a power grab…. It prescribes artificial constraints on what modern-day adaptable governance must look like. In telling Congress that it cannot entrust certain public-rights matters to the Executive because it must bring them first into the Judiciary's province, the majority oversteps its role and encroaches on Congress's constitutional authority. Its decision offends the Framers' constitutional design so critical to the preservation of individual liberty: the division of our Government into three coordinate branches to avoid the concentration of power in the same hands. The Federalist No. 51, p. 349 (J. Cooke ed. 1961) (J. Madison). Judicial aggrandizement is as pernicious to the separation of powers as any aggrandizing action from either of the political branches….

By giving respondents a jury trial, even one that the Constitution does not require, the majority may think that it is protecting liberty. That belief, too, is deeply misguided. The American People should not mistake judicial hubris with the protection of individual rights….

Because the Court disregards its own precedent and its coequal partners in our tripartite system of Government, I respectfully dissent.