Securities Litigation Alert

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Government Agencies Face Uncertainty After Supreme Court Rules that SEC ALJs Must Be Appointed

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Key Points

- SEC ALJs are "Officers of the United States" within the meaning of the Appointments Clause and therefore must be appointed directly by the SEC. The Court's decision may permit litigants in prior and pending administrative proceedings brought by the SEC or other agencies to obtain new hearings by challenging the constitutionality of the presiding ALJ.
- The Court declined to decide whether the statutory constraints on removing ALJs in 5 U.S.C. § 7521(a) are unconstitutional impairments on the President's ability to faithfully execute the law.

On Thursday, June 21, 2018, the Supreme Court held that administrative law judges (ALJs) presiding over cases brought by the U.S. Securities and Exchange Commission (SEC) are "Officers of the United States" within the meaning of the U.S. Constitution's Appointments Clause. *Lucia v. S.E.C.*, No. 17-130, 2018 WL 3057893 (U.S. June 21, 2018). Because petitioner Raymond Lucia's case was decided by an ALJ who had been hired by the SEC staff rather than by the Commissioners themselves, the Court held that Lucia was entitled to a new hearing before a different and properly appointed ALJ (or before the SEC itself). *Id.* at *8. The Supreme Court's decision resolved a circuit split as to whether the SEC's ALJs were "Officers" or mere employees, but the Court declined to add any gloss on existing precedent for assessing whether a particular federal official is an "Officer," nor did the Court address whether the statutory removal protections afforded ALJs unconstitutionally insulate them from the President's executive authority.

Background

In 2012, the SEC instituted an administrative proceeding against Lucia and his investment company for violations of the Investment Advisers Act, alleging that Lucia used deceptive advertising to market his retirement savings strategy called "Buckets of Money." In 2013, the presiding ALJ, Cameron Elliott, issued an initial decision concluding that Lucia had violated the Investment Advisers Act and imposing

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sanctions, including civil penalties of $300,000 and a lifetime bar from the investment industry. 2018 WL 3057893, at *4. Judge Elliott's decision made factual findings about only one of the four ways that the SEC thought Lucia's marketing misled investors, so the SEC remanded for fact-finding on the other three claims. *Id.* Judge Elliot then made additional findings of deception and issued a revised initial decision, with the same sanctions. *Id.*

Lucia appealed the revised initial decision to the SEC, arguing that the administrative proceeding was invalid because the presiding ALJ had not been constitutionally appointed. *Id.* The SEC rejected Lucia's argument, holding that the SEC's ALJs are not "Officers," but mere employees because its ALJs do not exercise "significant authority" independent of the SEC's supervision. *Id.*

Lucia then appealed to the Court of Appeals for the D.C. Circuit, where a panel of that court affirmed the SEC's view that SEC ALJs are not subject to the Appointments Clause because they are employees rather than officers. *Id.* (citing 832 F.3d 277, 283-89 (2016)). On rehearing, the 10-member *en banc* court divided evenly, resulting in a per curiam order denying Lucia's claim. *Id.* (citing 868 F.3d 1021 (2017)). The D.C. Circuit's decision created a circuit split with the 10th Circuit, which had ruled in *Bandimere v. SEC*, 844 F.3d 1168 (2016), that SEC ALJs are "Officers" subject to the Appointments Clause. 2018 WL 3057893, at *4.

Lucia petitioned for certiorari to the Supreme Court, and, in responding to Lucia's petition, the government switched sides—agreeing with Lucia that SEC ALJs are "Officers." *Id.* at *5. The Court granted certiorari and, because both sides agreed on the main legal question at issue in the appeal, the Court appointed an *amicus curiae* to defend the judgment below. *Id.* In November 2017, while the petition was pending, the Commission issued an order ratifying the prior appointment of its ALJs in an effort to "[t]o put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause[.]"

The Court's Decision

Writing for a six-justice majority, Justice Kagan held that SEC ALJs are "Officers" within the meaning of the Appointments Clause. The majority opinion concluded that Lucia's appeal was controlled by *Freytag v. Commissioner*, 501 U.S. 868 (1991), in which the Supreme Court held that U.S. Tax Court special trial judges ("STJs")—which Justice Kagan described as "near-carbon copies" of SEC ALJs—were "Officers" within the meaning of the Appointments Clause. 2018 WL 3057893, at *5. Like STJs, SEC ALJs hold a continuing office established by law and exercise significant discretion when carrying out important functions by, for example, taking testimony, receiving evidence, examining witnesses at hearings, conducting trials, ruling on the admissibility of evidence, and enforcing compliance with discovery orders. *Id.* at *6-7. Justice Kagan also noted that SEC ALJs' decisions can, in some cases, become final without review by the SEC. *Id.* at *7. She rejected the *amicus*' arguments that SEC ALJs are distinguishable from the STJs because SEC ALJs had less authority to punish contempt, and the Tax Court's rules expressly state that an STJ's findings of fact "shall be presumed" correct, finding that those distinctions "make no difference for officer status." *Id.* at *7-8 (citing Tax Court Rule 183(d)).

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Because SEC ALJs are "Officers" and Lucia "timely challenge[d]" the presiding ALJ's appointment, the Court concluded that Lucia was entitled to a new hearing before a properly appointed official. *Id.* at *8. Interestingly, the Court mandated that Lucia's new hearing must be conducted before a different ALJ (or before the SEC itself). As the Court held, because "Judge Elliot has already heard both Lucia's case and issued an initial decision on the merits . . . [h]e cannot be expected to consider the matter as though he had not adjudicated it before." *Id.*

Notably, the majority opinion did not address a separate question that the government had asked the Court to decide: whether, if SEC ALJs are "Officers," the statutory constraints on **removing** them as set forth in 5 U.S.C. § 7521(a) are unconstitutional impairments on the President's ability to faithfully execute the law. Also, because the majority held that *Freytag* decided the case, it offered no elaboration as to what characteristics are necessary to constitute the "significant authority" required for status as an "Officer" under Supreme Court precedent.

Justice Thomas, joined by Justice Gorsuch, filed a concurring opinion in which he agreed with the majority's analysis but added additional observations, drawn from his reading of historical materials from the time period in which the Constitution was adopted, that "Officers" should be construed to include any federal employee who performs a continuous public duty, regardless of whether that individual exercised significant authority. 2018 WL 3057893, at *9-10 (Thomas, J., concurring). The fact that Justice Gorsuch joined the concurrence suggests that he may be an adherent of the controversial "originalist" philosophy of judging most strongly associated with Justice Thomas and the late Justice Scalia.

Justice Breyer filed a separate opinion concurring in the judgment and dissenting in part. He argued that the Court should have decided the case based on statutory, not constitutional, grounds because the Administrative Procedures Act, 5 U.S.C. § 3105, requires each agency to "appoint as many administrative law judges as are necessary . . ." 2018 WL 3057893, at *11 (Breyer, J., concurring and dissenting in part). Justice Breyer argued that relying on the statute as the basis for the decision would have avoided the issue left unanswered by the Court – whether statutory protections for ALJs against removal are unconstitutional. *Id.* Part three of Justice Breyer's opinion, which was joined by Justices Sotomayor and Ginsburg, disagreed with the Court's conclusion that Lucia's rehearing was required to be either before the SEC or a different, properly appointed ALJ. *Id.* at *19.

Justice Sotomayor, joined by Justice Ginsburg, dissented, arguing that the "significant authority" necessary for status as an "Officer" must include "the authority, in at least some instances, to issue final decisions that bind the Government or third parties." 2018 WL 3057893, at *22 (Sotomayor, J., dissenting). Justice Sotomayor found that SEC ALJs lacked this authority because, unlike STJs in *Freytag* who could make final, binding decisions in certain cases, all SEC ALJ decisions are subject to review by the SEC. *Id.* at *21-22.

Takeaways

In the wake of the Court's decision, the SEC and other agencies face uncertainty about the validity of their administrative proceedings. The decision that SEC ALJs are "Officers" could potentially be extended to ALJs for other agencies, including, for example, the Social Security Administration, which employs the largest number of

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ALJs. Relatedly, although the SEC recently ratified the appointment of its ALJs, the decision might entitle litigants in current and recent administrative proceedings instituted prior to the ratification to rehearings, although such relief may not be available to litigants who did not raise a timely challenge and/or whose cases have already become final. Lastly, as Justice Breyer emphasized, the open question about authority to remove ALJs creates some continuing uncertainty as to whether properly appointed ALJs are subject to further constitutional attack.

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