
June 22, 2018

Supreme Court Rules That SEC Administrative Law Judge Appointments Violate The Constitution

On June 21, 2018, the Supreme Court held in *Lucia v. SEC*, No. 17-130, that the process by which the Securities and Exchange Commission (SEC) selects administrative law judges (ALJs) violates the U.S. Constitution. The Court concluded that SEC ALJs are “Officers of the United States,” who must be appointed by the Commission itself or by another proper authority under the Appointments Clause.

For pending cases that are tainted by an unconstitutional ALJ appointment, *Lucia* will require reassignment and rehearing of prior proceedings. In the near term, that is likely to be disruptive to the enforcement process at the SEC and other affected agencies, and beneficial to respondents in their administrative proceedings. Beyond pending cases in which a constitutional objection has been raised, the long-term implications of *Lucia* are less clear. The SEC and other federal agencies that employ ALJs may presumably satisfy the Constitution going forward through a process by which the “Heads of Departments” appoint the ALJs. In turn, ALJs may be subject to greater oversight by the political actors who appointed them. Whether this change in the method of selecting ALJs will meaningfully affect ALJ or agency decision-making is an open question.

Background of the Decision

The Appointments Clause

The Appointments Clause of the Constitution requires that “Officers of the United States” be appointed by the President with the advice and consent of the Senate, except that Congress may grant authority to appoint inferior Officers to (1) the President alone, (2) the Courts of Law, or (3) the “Heads of Departments.”¹ *Lucia* addressed whether SEC ALJs qualify as “Officers of the United States,” as opposed to mere employees.

The Supreme Court had previously explained that “Officers” occupy a “continuing” position established by law and exercise “significant authority pursuant to the laws of the United States,” as distinguished from

¹ In full, the Appointments Clause states that the President:

shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . inferior Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

U.S. Const. art. II, § 2, cl. 2.

lesser functionaries, whose appointments are not subject to the Appointments Clause.² In *Freytag v. C.I.R.*, the Court found that IRS special trial judges were “Officers” because they had significant duties and exercised significant discretion in performing important functions of a trial judge, including taking evidence, ruling on admissibility of evidence, conducting trials, and enforcing compliance with discovery orders.³ In certain classes of cases, the special trial judges could also enter final decisions on behalf of the Tax Court.⁴

SEC Administrative Law Judges

The SEC enforces the federal securities laws in contested cases by instituting an administrative proceeding before an ALJ, or by filing a civil action in federal district court. After the 2010 Dodd-Frank Act granted the SEC authority to collect penalties administratively against unregulated entities and individuals—a remedy previously available only in district courts—the SEC increasingly relied on administrative proceedings to prosecute its enforcement actions.⁵ For example, in the first half of 2017, the SEC brought 91 percent of its enforcement actions involving public companies as administrative proceedings.⁶

SEC ALJs preside over these administrative proceedings. They have authority to administer oaths, take testimony, admit or exclude evidence, and issue initial decisions.⁷ Subject to limited exceptions, review of ALJ decisions by the Commission is discretionary.⁸ If the Commission elects not to grant review, it will issue an order that deems the ALJ’s initial decision to be the final action of the Commission.⁹ Only after this process has run its course may the alleged securities law violator seek judicial review in the federal courts.

² *Buckley v. Valeo*, 424 U.S. 1, 126 & n.162 (1976).

³ 501 U.S. 868, 881-82 (1991).

⁴ *See id.* at 882.

⁵ *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 929P(a), 124 Stat. 1376, 1862-64 (2010); Andrew Ceresney, Director, SEC Division of Enforcement, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014), available at <https://www.sec.gov/news/speech/2014-spch112114ac> (explaining the SEC’s increased reliance on administrative proceedings after Dodd-Frank).

⁶ *See* Cornerstone Research & NYU Pollack Center for Law & Business, SEC Enforcement Activity: Public Companies and Subsidiaries Midyear FY 2017 Update, at 2 (2017), available at <https://www.cornerstone.com/Publications/Reports/SEC-Enforcement-Activity-Midyear-FY-2017-Update>.

⁷ 17 C.F.R. §§ 200.14, 200.30-9, 201.111.

⁸ *See* 15 U.S.C. § 78d-1(b); 17 C.F.R. § 201.411(b).

⁹ *See* 15 U.S.C. § 78d-1(c); 17 C.F.R. § 201.360(d).

The position of SEC ALJ, along with its duties, salary and means of appointment, was created by statute.¹⁰ The five incumbent SEC ALJs were hired by the SEC staff and not appointed by the President, a Court of Law, or the Head of Department.¹¹

Lucia's SEC Administrative Proceeding

In this case, the SEC brought an administrative proceeding against Raymond Lucia and his company for alleged violations of the Investment Advisors Act.¹² After the assigned ALJ held a hearing and issued an initial decision finding Lucia and his company liable, Lucia argued to the Commission that his administrative proceeding was invalid because the ALJ had not been constitutionally appointed.¹³ The Commission rejected this argument on the ground that its ALJs did not exercise significant independent authority. Lucia pursued this same argument before the D.C. Circuit, which held that the SEC's manner of appointing ALJs did not run afoul of the Appointments Clause.¹⁴

On November 30, 2017, in an attempt to put to rest any potential Appointments Clause issue, the Commission "ratified" the agency's prior appointments of its five incumbent ALJs (the "Ratification Order").¹⁵ As the Commission appears to qualify as the Head of a Department, its Ratification Order was intended to insulate ALJ proceedings from challenges under the Appointments Clause. The Commission also ordered the ALJs to conduct a fresh evaluation of the evidentiary record in all cases in which an initial decision had not yet been issued.¹⁶

On January 12, 2018, the Supreme Court granted *certiorari* to resolve a circuit split over whether the SEC ALJs had been appointed in violation of the Constitution.¹⁷

¹⁰ See slip op. at 8.

¹¹ See *id.* at 1.

¹² See *id.* at 2.

¹³ See *id.* at 3.

¹⁴ See *Raymond J. Lucia Cos. v. Sec. & Exch. Comm'n*, 832 F.3d 277, 280, 285-86 (D.C. Cir. 2016).

¹⁵ See Order, *In re Pending Administrative Proceedings*, Securities Act Rel. No. 10440 (Nov. 30, 2017); Exchange Act Rel. No. 82178 (Nov. 30, 2017), available at <https://www.sec.gov/litigation/opinions/2017/33-10440.pdf>.

¹⁶ See *id.*

¹⁷ Compare *Raymond J. Lucia Cos., Inc. v. Sec. & Exch. Comm'n*, 868 F.3d 1021 (D.C. Cir. 2017) (*per curiam*) (denying Lucia's petition for review), with *Bandimere v. Sec. & Exch. Comm'n*, 844 F.3d 1168, 1179 (10th Cir. 2016) (holding that SEC ALJs are "inferior Officers" whose method of hiring violated the Appointments Clause).

The Supreme Court's Decision

In an opinion written by Justice Kagan on behalf of herself and five other members of the Court, the Supreme Court held that SEC ALJs are “Officers of the United States” subject to the Appointments Clause. The Court described a two-part framework for analyzing whether an individual is an Officer of the United States: the individual must (1) “occupy a ‘continuing’ position established by law,” and (2) have “significant authority pursuant to the laws of the United States” and exercise “significant discretion” in carrying out that authority.¹⁸ The Court did not, however, require “Officers” to have authority to make final decisions that are binding on the government.

Characterizing SEC ALJs as “near-carbon copies” of the special trial judges in *Freytag*, the Court found that SEC ALJs exercise “significant authority” to: (1) take testimony; (2) conduct trials; (3) rule on the admissibility of evidence that critically shapes the administrative record; and (4) enforce compliance with discovery orders to punish contemptuous conduct.¹⁹ With respect to the fourth category, the Court found it was not necessary for “Officers” to have authority to punish contempt by imprisonment or fines, at least where the ALJ has formal authority to exclude a wrongdoer from the proceedings and substantial informal power over the proceedings through the ability to issue an opinion with factual findings, legal conclusions, and sanctions.²⁰

Having determined that SEC ALJs are “Officers of the United States” subject to the Appointments Clause, the Court turned to the question of remedy. Because the charges against Lucia were not adjudicated by a constitutionally appointed officer, the Court remanded the case for a new proceeding before a different ALJ or the Commission itself.²¹ Importantly, the Court concluded that the ALJ who oversaw Lucia’s original proceeding could not oversee the new proceeding, even if he were to receive a constitutionally valid appointment. Because that ALJ had already issued an initial decision on the merits against Lucia, he could not be expected to consider the matter as though he had not adjudicated it before.²²

¹⁸ Slip op. at 6-7 (citations omitted).

¹⁹ *Id.* at 6, 8-9.

²⁰ *See id.* at 10-11.

²¹ *See id.* at 12-13.

²² *See id.* at 12.

The Separate Opinions

Justice Thomas's Concurrence

In addition to joining the majority opinion, Justice Thomas, joined by Justice Gorsuch, wrote a concurrence intended to provide greater guidance on the meaning of the phrase “Officers of the United States.” Invoking the Founders’ original understanding, Justice Thomas construed this phrase to include all federal civil officials who perform any ongoing statutory duty. In his view, SEC ALJs “easily” satisfy this test because they exercise statutory duties, including issuing initial decisions in adversarial proceedings.

Justice Breyer's Opinion Concurring in the Judgment in Part and Dissenting in Part

Justice Breyer wrote an opinion concurring in the judgment in part and dissenting in part, which Justices Ginsburg and Sotomayor joined as to the dissenting portion. First, although Justice Breyer agreed with the majority that the SEC had improperly appointed the ALJ in Lucia’s case, he would have resolved that issue based on the Administrative Procedure Act to avoid raising constitutional questions about ALJ removal protections that might undermine ALJ independence. Second, in light of the Commission’s Ratification Order, Justice Breyer dissented from the majority’s remedy requiring Lucia’s new hearing to be held before a different ALJ.

Justice Sotomayor's Dissent

Justice Sotomayor, joined by Justice Ginsburg, dissented. She would have held that individuals cannot qualify as “Officers of the United States” unless they have the ability to make “final, binding decisions on behalf of the Government.” In her view, SEC ALJs do not satisfy this requirement because the Commission retains ultimate authority over the ALJs’ rulings.

Implications of the Supreme Court's Decision

While the significance of the Supreme Court’s decision in *Lucia* is difficult to forecast, it is likely to have a greater direct impact on pending cases than on future administrative proceedings.

With respect to cases going forward, the Commission is expected to take the position that it has already satisfied the constitutional appointment requirement for ALJs. As noted, the Commission ratified the prior appointment of the SEC’s five ALJs on November 30, 2017.²³ The Supreme Court did not address Lucia’s challenge to the validity of the Ratification Order, leaving open the possibility that administrative

²³ See Ratification Order.

proceedings commenced after November 30, 2017 may properly continue.²⁴ Nonetheless, respondents in SEC administrative proceedings may challenge the Commission's "ratification" as an ineffective "appointment" under the Constitution. Thus, to avoid further litigation over the Ratification Order, it is possible that the Commission will conduct a formal appointment process for its ALJs, including a Commission vote, oaths of office, and delivery of commissions. Should the Commission take this relatively modest step, the direct long-term impact of *Lucia* (at least for securities enforcement) may be quite limited.

On the other hand, *Lucia* is likely to disrupt pending SEC administrative proceedings significantly. Since the remedy for an adjudication tainted by an appointments violation is a new hearing before a properly appointed official, pending SEC administrative proceedings may require reassignment to a constitutionally appointed officer. Indeed, even if the Commission were to appoint the same five ALJs who were hired under the previous system, *Lucia* may prompt the SEC to reassign and rehear pending administrative cases anew. Should that occur, respondents might raise statute of limitations challenges to certain new administrative orders instituting enforcement proceedings.²⁵

At the time of the Commission's Ratification Order, there were approximately 104 pending SEC administrative proceedings in which an ALJ had issued an initial decision.²⁶ Another 133 SEC administrative proceedings were added between October 1, 2017 and March 31, 2018.²⁷ A meaningful number of these proceedings were likely disposed of prior to the decision in *Lucia*, and fewer still were subject to timely constitutional challenges. According to Lucia's brief in the Supreme Court, there were only 13 cases pending in federal appellate courts on petitions for review of SEC enforcement actions.²⁸ But the impact of *Lucia* will be felt well beyond the SEC. There are roughly 1,900 ALJs across all federal agencies.²⁹ Though most of these ALJs oversee proceedings for Social Security benefits, Lucia advised the

²⁴ The Solicitor General of the United States appeared to take this position, even though the Solicitor General declined to defend the SEC's original merits position on the Appointments Clause. See Reply Brief for Respondent Supporting Petitioners at 19-21 (Apr. 16, 2018).

²⁵ See, e.g., 28 U.S.C. § 2462 (imposing five-year statute of limitations from the date "when the claim first accrued" on commencement of government "enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise"); see also *Gabelli v. SEC*, 133 S. Ct. 1216, 1224 (2013) (statute of limitations not subject to a discovery rule).

²⁶ See Ratification Order, Ex. A.

²⁷ See SEC Report on Administrative Proceedings for the Period October 1, 2017 Through March 31, 2018, Exchange Act Rel. No. 83137 (Apr. 30, 2018).

²⁸ See Brief for Petitioners at 48-49 (Feb. 21, 2018).

²⁹ See Office of Personnel Management, *Administrative Law Judges: ALJs by Agency* (Mar. 2017), available at <http://www.opm.gov/services-for-agencies/administrative-law-judges/#url=ALJs=by-Agency>.

Supreme Court that there are still around 150 ALJs in 25 government agencies that preside over adversarial enforcement proceedings akin to SEC ALJs.³⁰

Looking ahead, the more indirect effects of the Court's decision in *Lucia* are even less clear. A system of constitutional appointment may subject ALJs to greater oversight by political actors, such as the Head of Department or even the President of the United States. However, the Supreme Court declined to clarify the scope of *removal* powers for ALJs, as the Solicitor General urged it to do, which would have more readily affected ALJ behavior than changing the *appointing* party. Likewise, it remains an open question whether *Lucia* will affect decision-making for agencies when deciding whether to bring enforcement actions administratively or in federal court.

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³⁰ See Brief for Petitioners at 41-42 (Feb. 21, 2018); Reply Brief for Petitioners at 19 (Apr. 13, 2018).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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