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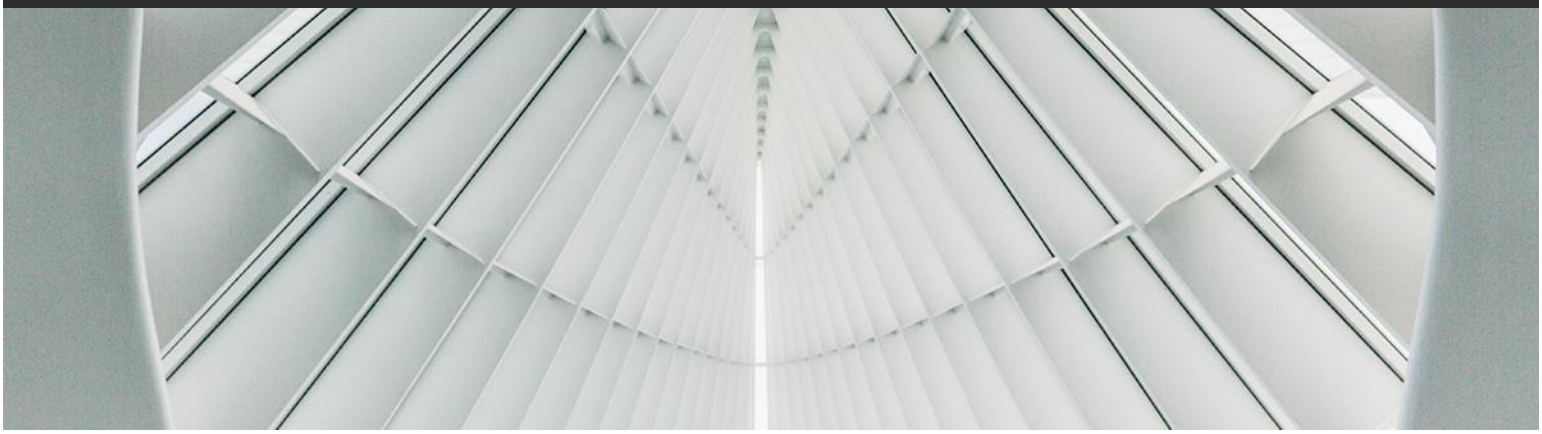

June 2018

Supreme Court Invalidates Appointment of SEC ALJs as Violating the Constitution

On Thursday, June 21, the Supreme Court ruled that the Securities and Exchange Commission's (SEC) administrative law judges are "officers" of the United States and must therefore be appointed in accordance with Article 2, Section 2, Clause 2 of the Constitution (the Appointments Clause), which requires that officers be selected by the president, a court of law, or a head of department. Because the SEC's ALJs were appointed by its staff in violation of the Appointments Clause, they have been deciding cases without constitutional authority for decades.

Many other agencies employ ALJs the way the SEC does. Given the broad scope of the decision, the legitimacy of these federal agency ALJs—and some of the adjudicative decisions they have rendered—is now in doubt. For practitioners who appear before the SEC and other agencies, *Lucia*'s import cannot be overstated.

Background

Raymond J. Lucia had a 40-year career as an investment professional. In his later years, Lucia promoted a retirement strategy he dubbed "Buckets of Money" and used a slideshow to compare his approach to others using hypothetical examples. The SEC took issue with Lucia's use of these hypotheticals and charged him with securities fraud in 2012.

Lucia's case was adjudicated before SEC ALJ Cameron Elliot, who oversaw a "trial-like hearing" featuring documentary evidence, witness testimony, and cross-examinations. ALJ Elliot ultimately found Lucia

liable, imposed a $300,000 fine, and barred him for life from working as an investment adviser or associating with those in the industry. Lucia sought review of that decision by the SEC, where he challenged ALJ Elliot's decision on the merits and, separately, argued the ALJ held his office in violation of the Appointments Clause. With respect to the latter point, Lucia relied upon an earlier decision of the Supreme Court, *Freytag v. Commissioner*, which addressed the status of certain administrative adjudicators closely similar to ALJs working in another agency.

The SEC granted discretionary review and affirmed ALJ Elliot's ruling in 2015. The SEC found that its ALJs are not subject to the requirement of the Appointments Clause because the SEC's right to discretionary review meant that its ALJs' decisions are not independently final. The D.C. Circuit upheld that result in a 2016 decision, finding that SEC ALJs are mere employees and thus exempt from the requirements of the Appointments Clause. When the D.C. Circuit heard the case *en banc*, however, newly-appointed Solicitor General Francisco changed course, and sided with Lucia's view that the SEC's ALJs were appointed unlawfully.[1] The D.C. Circuit reached a 5-5 deadlock on the issue, leaving the 3-judge panel's 2016 decision intact. Both Lucia and the Solicitor General petitioned for certiorari in November. The very next day, the SEC attempted to blunt the future impact of the litigation by issuing an order that purported to "ratify" the appointment of its ALJs. The Supreme Court nonetheless heard the case in April 2018.

Opinion

Writing for the Court, Justice Kagan held that the SEC's ALJs are "officers" within the meaning of the Appointments Clause and, thus, had to be appointed in accordance with the clause. Because ALJ Elliot was appointed by SEC staff, his appointment was thus unconstitutional. The Court held the appropriate remedy for his unlawful adjudication of Lucia's case must be "a new 'hearing before a properly appointed' official" and "that official cannot be [administrative law] Judge Elliot, even if he has now received (or receives sometime in the future) a constitutional appointment." Instead, "to cure the error, another ALJ (or the Commission itself) must hold the new hearing to which Lucia is entitled."

Anchoring her holding firmly within the Court's precedent, Justice Kagan cited *Freytag*, which held that "special trial judges" of the tax court are officers under the Appointments Clause. In so doing, Justice Kagan noted that the special trial judges in *Freytag* "are near carbon-copies of the Commission's ALJs," observing that "[b]oth sets of officials have all the authority needed to ensure fair and orderly adversarial hearings—including nearly all the tools of federal trial judges." These similarities, she wrote, provide "everything necessary to decide this case." She took no position, however, on the efficacy of the SEC's *ex post facto* "ratification" of its ALJs. Justice Kagan was joined by five of her colleagues—Justices Kennedy, Thomas, Alito, and Gorsuch, as well as Chief Justice Roberts.

Justice Thomas (along with Justice Gorsuch) concurred, implying that the Court's decision should be even more expansive based on his view that all federal civil officials maintaining "ongoing statutory dut[ies] are officers within the meaning of the Appointments Clause."

Justice Breyer's concurrence departed from the majority in two noteworthy respects. He agreed that ALJ Elliot's appointment was unlawful, but would have avoided the constitutional issue by instead relying on the Administrative Procedure Act. He also disagreed with the remedy the majority proposed for Lucia. Justice Breyer (joined by Justices Sotomayor and Ginsburg in this respect) believed that a re-do before

[1] That view was shared by the Court of Appeals for the Tenth Circuit, which held that SEC ALJs are officers within the meaning of the Appointments Clause in its 2016 decision, *Bandimere v. SEC*.

ALJ Elliot (assuming he were to receive a constitutional re-appointment) would suffice. He noted the Commission's attempt at "ratification," but expressed no view as to its efficacy.

Justice Sotomayor (joined by Justice Ginsburg) dissented. She relied upon an argument rejected expressly by the majority—because their decisions are subject to the SEC's discretionary review, SEC ALJs "lack final decisionmaking authority" and are thus mere employees rather than officers.

Significance

The Invitation for Expanded Scrutiny

Some of the Justices, it seems, were troubled by the apparent breadth of the decision, and grappled with the far-reaching scope of its anticipated consequences. Justice Breyer foretold the potential "unraveling, step-by-step," of the federal government's administrative adjudication system. Concerned by this possibility, he would seem to exempt the largest group of ALJs—those of the Social Security Administration—from the Court's holding. Even so, that still leaves approximately 150 ALJs working in 25 federal agencies vulnerable to *Lucia*'s holding. And that may not be all.

The Court's functional approach also invites scrutiny of other civil servants holding "continuing position[s] established by law" and who exercise "significant authority pursuant to the laws of the United States." Though ALJs who, by virtue of their job functions, are "near carbon-copies" of *Freytag's* special tax judges are certainly vulnerable under *Lucia*, the Court left open the possibility that others are, too. Indeed, "significant authority" is no longer synonymous with "final decisionmaking authority." Leaving resolution of the precise contours of this expression for another day, the Court has all but invited future Appointments Clause-based challenges to any and all civil servants who arguably exercise "significant authority."

On the other hand, the Court did resolve that the appointment of ALJs who perform functions similar to those undertaken by ALJ Elliot—holding adversarial hearings, accepting evidence, and the like—are suspect under the constitution. *Lucia* affords aggrieved litigants who made timely Appointments Clause-based challenges to these ALJs a second opportunity to be heard. The Court not only suggested as much, but it even encouraged these challenges, stating: "our Appointments Clause remedies are designed not only to advance [the structural purposes of the Appointments Clause] directly, but also to create []incentive[s] to raise Appointments Clause challenges." Such challenges would seem to be appropriate, at a minimum, in the context of pending cases.[2] And there is no telling whether they would also be an appropriate device for seeking review of decided cases.

The Uncertain Future of Removal Protections

The Court declined to address an important constitutional question posed by the Solicitor General: whether the "for cause" removal protections afforded to ALJs violates the Appointments Clause by adding "two layers of protection from removal without cause." As Justice Breyer posited, because the framers envisioned that "officers" would be accountable to the executive "to hold that the administrative law judges are "Officers of the United States" is, *perhaps*, to hold that their removal protections are unconstitutional."

[2] An open question remains as to the status of previous decisions by SEC ALJs who were not hired pursuant to the Appointments Clause, as well as pending matters before SEC ALJs. Perhaps recognizing as much, on Friday, June 22, the SEC issued an Order staying for 30 days "any pending administrative proceeding…before an administrative law judge, including any such proceeding currently pending before the Commission."

The enhanced scrutiny of officers under the Appointments Clause might well lead to the appointment of individuals who, by their nature and qualifications, will be more independent in exercising their duties. Or it might not. Though the Appointments Clause seeks to protect, rather than inhibit, the independence of the officers falling within its purview, some might fear the erosion of ALJs' removal protections will result in the opposite consequence—a system where adjudicators are beholden to the partisan values of the executive. Justice Breyer seemed to suggest as much, warning against "transforming administrative law judges from independent adjudicators into dependent decisionmakers, serving at the pleasure of the Commission." Because the Court declined the Solicitor General's invitation, the normative arguments informing this debate—as well as the practical consequences of its resolution—will have to wait for another day.

Authors

This GT Alert was prepared by **Steven M. Felsenstein**, **Elaine C. Greenberg, Laura Metcoff Klaus, Mark E. Solomons, Terry R. Weiss,** and **Michael Pusateri**. Questions about this information can be directed to:

- Steven M. Felsenstein | +1 215.988.7837 | felsensteins@gtlaw.com
- Elaine C. Greenberg | +1 202.331.3106 | greenberge@gtlaw.com
- Laura Metcoff Klaus | +1 202.533.2362| klausl@gtlaw.com
- Mark E. Solomons | +1 202.533.2361| solomonsm@gtlaw.com
- Terry R. Weiss | +1 678.553.2603 | weisstr@gtlaw.com
- Michael Pusateri | +1 202.533.2354 | pusaterim@gtlaw.com
- Or your Greenberg Traurig attorney