Appointed Not Hired: The Supreme Court Rules on the SEC's Administrative Law Judges

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On June 21, in its much-anticipated decision in *Lucia v. Securities and Exchange Commission*, the U.S. Supreme Court held that the SEC's Administrative Law Judges ("ALJs") are officers under the Constitution's Appointments Clause. The decision requires that, moving forward, SEC ALJs be constitutionally appointed rather than hired like other employees. In response to the decision, the SEC issued an order immediately staying for 30 days "pending administrative proceeding initiated by an order instituting proceedings that commenced the proceeding and set it for hearing before an administrative law judge, including any such proceeding currently pending before the Commission." *Lucia* will likely also have wide-ranging implications for ALJs across dozens of federal agencies. For Lucia himself, the decision mandates a new hearing before a "properly appointed official." For others, the opinion leaves open a number of important questions, including how this decision will impact pending SEC administrative proceedings and how far *Lucia*'s reasoning extends.

The Constitution's Appointments Clause requires that an "officer" of the United States be appointed by the president, the courts of law, or by the heads of departments. SEC ALJs have traditionally not been appointed by the President, the judiciary, or even the SEC's Commissioners. Rather, SEC ALJs are hired through the SEC's Office of Human Resources. They have delegated authority to hear administrative proceedings and issue "initial decisions," which must be finalized by an order from the Commissioners, who also retain the authority to review ALJ decisions either *sua sponte* or on appeal.

The matter before the Supreme Court arose from an ALJ's initial decision finding Raymond J. Lucia and his investment company liable for fraud stemming from alleged violations of the Investment Advisers Act. The SEC upheld the ALJ's decision on review, rejecting Lucia's argument that proceeding before an ALJ was invalid because the ALJ had not been appointed in accordance with the Appointments Clause of the Constitution. The SEC relied on a D.C. Circuit case, *Landry v. FDIC*,[1] which had held that ALJs were not "inferior officers" within the meaning of the Appointments Clause and thus did not have to be appointed.

On appeal, a unanimous panel of the D.C. Circuit agreed with the SEC and held that SEC ALJs are not officers but rather employees. According to the D.C. Circuit, ALJs did not meet the standard of exercising "significant authority pursuant to the laws of the United States," which had been set by the Supreme Court in *Buckley v. Valeo*.[2] The D.C. Circuit upheld the decision en banc, creating a split with the Tenth Circuit. *See Bandimere v. SEC*, 844 F. 3d 1168 (10th Cir. 2016). Lucia then petitioned the Supreme Court for a writ of certiorari.

Writing for a six-justice majority, Justice Kagan agreed with Lucia and the Tenth Circuit, holding that SEC ALJs are "inferior officers" and thus subject to the requirements of the Appointments Clause. The majority cited *Freytag v. Commissioner*,[3] a similar case which held that Tax Court "special trial judges" were officers for purposes of the Appointments Clause, as providing "everything necessary to decide this case." Because the special trial judges at issue in *Freytag* were "near carbon-copies

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of the Commission's ALJs," the Court applied *Freytag*'s two-part test to resolve *Lucia*. First, the Court analyzed whether the ALJs "hold a continuing office established by law," a criterion easily met—and in fact conceded by all parties—because SEC ALJs receive career appointments to positions created by statute. Thus, the Court needed only to decide whether SEC ALJs "exercise the same 'significant discretion' [as the *Freytag* judges] when carrying out the same 'important functions' as [special trial judges] do." The Court easily resolved that question in the affirmative, holding 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."

We anticipate that the SEC may assert that the consequences of *Lucia* have been mitigated by the fact that, after the Supreme Court granted certiorari, the Commission ratified the appointments of its ALJs. However, the Court did not squarely address the validity of those ratifications, instead noting in a footnote that the Commission had not indicated that it would have Lucia's case assigned to an ALJ pursuant to that ratification. The Court hinted that the SEC could hear the case itself or have it assigned "to an ALJ who has received a constitu¬tional appointment independent of the ratification." This potentially leaves all pending SEC administration proceedings in a state of limbo until the Commission affirmatively appoints the sitting ALJs or the ratification issue is litigated.

Additionally, the Court expressly declined to consider whether the Administrative Procedure Act's statutory "for cause" removal protections are constitutional. *See Free Enterprise Fund v. Public Company Accounting Oversight Bd.*, 561 U.S. 447 (2010). As Justice Breyer pointed out in his concurrence, holding that SEC ALJs are "inferior officers" without addressing statutory restrictions on their removal invites continuing constitutional battles.

Finally, although the Court's prime directive to the SEC is at least clear—in the future, ALJs must be appointed by the Commission—less clear is the fate of the approximately 150 ALJs scattered across dozens of federal agencies with discretion analogous to the SEC ALJs. Given the fact-intensive nature of the Court's analysis under *Freytag*, and the still-open questions regarding limitations on the removal of ALJs, *Lucia* seems poised to leave a rash of litigation in its wake.

Read the full text of the opinion. For additional information regarding the consequences of *Lucia* on pending administrative proceedings, or our firm's experience in litigating proceedings before the SEC's ALJs more generally, contact the following Haynes Boone attorneys.

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[1] 204 F.3d 1125 (D.C. Cir. 2000).

[2] 96 S.Ct. 612 (1976).

[3] 501 U.S. 868 (1991).

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