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Supreme Court Rules SEC ALJ Appointments Unconstitutional But Leaves Important Questions Unanswered

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June 28, 2018 – On June 21, 2018, the Supreme Court ruled in *Lucia v. SEC* that administrative law judges ("ALJs") employed by the Securities and Exchange Commission ("SEC") to adjudicate enforcement actions are executive inferior "officers" within the meaning of the Appointments Clause of the U.S. Constitution, resolving a split between the Tenth and D.C. Circuits.[i] As such, SEC ALJs must be appointed by the President, a court of law, or the head of a department or agency, and not selected by SEC staff, as has been the agency's longtime practice.[ii] Justice Kagan, writing for the majority, declined to address the validity of the SEC's effort in November 2017 to retroactively "ratify" the prior "appointments of the sitting SEC ALJs," as well as the constitutionality of statutory tenure protections on removing SEC ALJs. The decision all but ensures future litigation on these thorny ratification and removal issues.

Lucia came to the Court from the D.C. Circuit, where Raymond Lucia challenged sanctions imposed by the SEC on the basis that the ALJ presiding over his case was an officer of the United States who had not been appointed in accordance with the Appointments Clause. This defect, Lucia argued, rendered the ALJ's decision—which was later confirmed by the SEC—a legal nullity.[iii] A panel of the D.C. Circuit disagreed, finding that SEC ALJs are mere employees of the agency and not subject to the Appointments Clause.[iv] Months later, a divided panel of the Tenth Circuit reached the opposite conclusion.[v]

While Lucia's petition for a writ of certiorari was pending in the Supreme Court, the Justice Department—which had up to that time defended the constitutionality of the SEC's ALJs in the courts of appeals—switched the litigating position of the SEC and conceded that the ALJs are, in fact, officers of the United States.[vi] This about-face prompted the SEC to issue an order in November 2017 "ratify[ing] the agency's prior appointment of" its five ALJs and establishing procedural steps, including the remand of administrative cases to an ALJ for readjudication, intended to cure the constitutional issues presented in those cases.[vii]

The Supreme Court explained that its holding was compelled by its earlier decision in *Freytag v. Commissioner*,[viii] which the Court characterized as involving "adjudicative officials who are near-carbon copies of the [SEC's] ALJs."[ix] The ALJs hold a continuing office established by law and possess significant discretion in carrying out their adjudicative functions (including the ability to receive evidence, as well as the ability to make factual findings, render legal conclusions, and mete out appropriate remedies), and thus qualify as Article II "officers."[x] The Court also rejected the argument that SEC ALJs are mere employees because their opinions are subject to higher levels of review (a position adopted by the D.C. Circuit in *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000), and upon which the D.C. Circuit panel relied in *Lucia*).[xi]

Having concluded that the ALJ who presided over Lucia's case was not constitutionally appointed, the Supreme Court remanded for rehearing before a *different* ALJ who has been constitutionally appointed, or before the SEC itself. In crafting this remedy, the Court did not squarely address the SEC's attempt to retroactively ratify the appointments of all its currently-serving ALJs in November 2017, observing that this issue was not yet ripe for resolution in this case.[xii]

The majority also avoided the nettlesome question of whether the statutory removal restrictions applicable to ALJs are an impermissible limitation on the President's Article II power to remove executive officers at will, preferring to wait for "thorough lower court opinions to guide [the high court's] analysis of the merits."[xiii] In his separate opinion, Justice Breyer took issue with the Court's failure to consider the "embedded" statutory removal question before the constitutional Appointments Clause question. According to Justice Breyer, the Court's decision to rule on constitutional grounds and leave for another day the statutory removal question "risks . . . unraveling, step-by-step, the foundations of the Federal Government's administrative adjudication system as it has existed for decades, and perhaps of the merit-based civil-service system in general."[xiv]

The Court's narrow reasoning in *Lucia* leaves much to be decided in the months and years to come. Indeed, the same day the *Lucia* decision was handed down, the SEC issued an order to "stay any pending administrative proceeding" before an ALJ for "30 days or further [pending] order of the Commission."[xv] Litigants in ongoing SEC proceedings will no doubt continue to challenge the propriety of the Commission's post hoc effort to ratify the "appointments" of its judges. Similarly, separation-of-powers challenges based on two-level tenure protections of the Commission's ALJs will continue to be pressed in the federal courts.

The *Lucia* decision will do little to quell constitutional challenges to in-house judges across the administrative state, leading to a potential reconfiguration of how federal agencies appoint, oversee, and terminate their in-house judges.

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[i] *Lucia v. SEC*, No. 17–130, slip op. (June 21, 2018), **https://www.supremecourt.gov/opinions/17pdf/17-130_4f14.pdf**. The Court did not explore whether SEC ALJs were considered "principal" or "inferior" officers within the meaning of Appointments Clause, as the distinction was unnecessary to decide the case.

[ii] U.S. Const. art. II, § 2, cl. 2.

[iii] *Raymond J. Lucia Companies, Inc. v. SEC*, 832 F.3d 277, 283 (D.C. Cir. 2016), *pet. denied upon rehearing en banc by an equally divided court*, 868 F.3d 1021 (D.C. Cir. 2017), *rev'd sub nom. Lucia v. SEC*, No. 17–130, slip op. (June 21, 2018), **https://www.supremecourt.gov/opinions/17pdf/17-130_4f14.pdf**.

[iv] The full D.C. Circuit, sitting en banc, reheard Lucia's case, but divided evenly, leaving the panel opinion in place.

[v] *See Bandimere v. SEC*, 844 F.3d 1168 (2016), *petition for cert. filed*, No. 17–475 (U.S. Sept. 29, 2017).

[vi] The Supreme Court appointed an amicus to defend the judgment below that the SEC's ALJs were not "officers" within the meaning of the Appointments Clause.

[vii] Order, *In re: Pending Administrative Proceedings* (Nov. 30, 2017), **https://www.sec.gov/litigation/opinions/2017/33-10440.pdf**.

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

[ix] *See Lucia*, No. 17–130, slip op. at 6.

[x] *Id.* at 8–10.

[xi] *Id.* at 11; *see also* 832 F.3d at 284–88.

[xii] *Lucia*, No. 17–130, slip op. at 12–13 & n.6.

[xiii] *Id.* at 4 n.1 (quoting *Zivotofsky v. Clinton*, 566 U.S. 189, 201 (2012)).

[xiv] *Id.* (Breyer, J. concurring and dissenting op.) at 1, 14.

[xv] Order, *In re: Pending Administrative Proceedings* (June 21, 2018), **https://www.sec.gov/litigation/opinions/2018/33-10510.pdf**. The Order does not preclude the Commission "from assigning any proceeding currently pending before an administrative law judge to the Commission itself or any member of the Commission at any time."

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