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## Supreme Court Holds SEC's Past Hiring of Administrative Judges Unconstitutional

On Thursday, the Supreme Court issued a decision in *Lucia v. SEC*, Dkt. No. 17–130, holding that the SEC's previous practice in hiring administrative law judges ("ALJs") was unconstitutional—calling into question the validity of the proceedings and holdings of SEC ALJs that decide the vast majority of contested SEC enforcement actions. With this decision, the Court resolved an outstanding circuit split as to whether SEC ALJs are "officers" of the United States subject to the requirement of the Appointments Clause that all such officers be appointed by the President, "courts of law," or "heads of department." The Court concluded that ALJs are "officers" who must be appointed pursuant to the Appointments Clause but, in doing so, declined to address a number of open questions that follow from this significant decision.

### Background and Procedural History

Raymond Lucia was an investment adviser charged by the SEC under the anti-fraud provisions of the Investment Advisers Act for misleading investors. As a result, the SEC pursued an enforcement action against him in front of an ALJ. The ALJ found Lucia liable, and imposed a \$300,000 fine and a lifetime ban on serving as an investment adviser. Lucia appealed that judgment to the Commission, which affirmed the decision by a 3-2 vote.

Lucia then appealed to the D.C. Circuit, arguing that under *Freytag v. Commissioner*, 501 U.S. 868 (1991), SEC ALJs are the type of "inferior officers" governed by the Appointments Clause. The Supreme Court had held in *Freytag* that Tax Court Special Trial Judges ("STJs") are "inferior officers" because, among other reasons, they have the power to take testimony, conduct trials, rule on the admissibility of evidence, and enforce discovery orders. Leaning on *Freytag*, Lucia argued that the ALJ in his case had exercised similar discretion over a trial-like procedure and, therefore, must be appointed by the President or the SEC Commission under the Appointments Clause. The D.C. Circuit rejected Lucia's reliance on *Freytag* and instead relied on its own prior holdings to find that ALJs are "employees," rather than "officers," of the SEC and, therefore, that they are not subject to the Appointments Clause.

Lucia filed a petition for rehearing *en banc*. While the petition was pending, the Tenth Circuit issued a decision in *Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016), holding contrary to the D.C. Circuit that the SEC's ALJs are indeed "officers," rather than "employees." After *Bandimere* was decided, the D.C. Circuit granted Lucia's rehearing request but deadlocked with an equally divided court, leaving the panel's decision in place. Lucia then filed a petition for certiorari to the Supreme Court based on the split between the D.C. and Tenth Circuits.

### The Supreme Court's Decision

The Supreme Court granted certiorari on the "sole question [of] whether the Commission's ALJs are 'Officers of the United States' or simply employees of the Federal Government," and by a 6-3 margin, held that SEC ALJs are officers subject to the Appointments Clause. *Lucia v. SEC*, Dkt. No. 17–130, slip op. at 1, 5 (S. Ct. June 21, 2018). Unlike the D.C. Circuit, the Supreme Court's majority opinion—written by Justice Kagan and joined by Chief Justice Roberts and Justices Kennedy, Thomas, Alito, and Gorsuch—concluded that "*Freytag* says everything necessary to decide this case." *Id.* at 8. Indeed, the majority found there to be no principled distinction between the STJs in *Freytag* and the ALJs in *Lucia*, calling them "near-carbon copies." *Id.* at 6. As Justice Kagan pointed out, both the STJs and the ALJs hear testimony, conduct trials, rule on the admissibility of evidence, and enforce compliance with discovery orders. *Id.* at 8–9. Moreover, the Court observed that the ALJs' decisions likely exhibit a

higher degree of independence than those of the STJs, given that the ALJs' initial findings of fact and law become final if the SEC declines review. *Id.* at 9.

As a result, the majority decided that Lucia was entitled to a new hearing and—in a conclusion to which Justice Breyer raised strenuous objections—that such a proceeding should occur in front of a different ALJ than the one that had previously decided his case. This latter holding was necessary, according to the majority, despite the fact that the SEC had issued an order in November of 2017 purporting to ratify the prior appointment of its ALJs, because the ALJ “cannot be expected to consider the matter as though he had not adjudicated it before.” *Id.* at 12.

## Implications

The decision in *Lucia* leaves a number of questions unanswered. First, the Court declined to address the thorny question of how either the SEC or other prior litigants in front of its ALJs should proceed. The Court expressly declined to decide whether the SEC's attempt to “ratify” the appointment of its ALJs in November of 2017 successfully cures the constitutional problem. *Id.* at 13 n.6. As a result, it remains unclear whether the SEC's current ALJs occupy those posts constitutionally, or whether additional remedial action by the Commission is necessary (for instance, the SEC could now formally “appoint” the current ALJs going forward, as opposed to the prior “ratification”). Separately, the Court also declined to decide what, if any, remedy is available to litigants who did not make a “timely challenge” to the constitutionality of their proceedings. For some litigants—including those who failed to raise the issue and have now exhausted the time for appeal—today's opinion likely offers little in the way of relief. For others—namely, those who properly raised a challenge prior to the SEC's “ratification” and who still have a pending appeal—today's decision may offer some relief, depending on whether and how the SEC is able to cure the constitutional issue. Between those extremes, however, exist a number of litigants—including, by the SEC's estimate, those in the 106 cases for which an ALJ had already issued an initial decision at the time of the Commission's ratification order—for whom the import of today's decision is much less clear.

Second, it is not clear whether, or to what extent, this decision will affect other administrative agencies that use a comparable process to hire ALJs that are then vested with adjudicatory powers similar to those at issue here. Both the parties and the Court expressed sometimes-conflicting views as to the effect of any decision on other administrative agencies, and the opinion provides no insight as to the expected scope of the holding. Additionally, Justice Breyer urged in dissent that the Court's ruling *may* call into question the constitutionality of the removal protections afforded to ALJs under the Administrative Procedure Act. Both of these questions have the potential to generate substantial uncertainty for administrative proceedings in the near term.

For advice or assistance in dealing with this important clarification of the law, please contact your regular Ropes & Gray advisor.