

RESTRUCTURING THE ADMINISTRATIVE STATE: SUPREME COURT DECIDES SEC ALJS ARE "OFFICERS OF THE UNITED STATES" SUBJECT TO THE CONSTITUTION'S APPOINTMENTS CLAUSE

On June 21, 2018, the U.S. Supreme Court held in *Lucia v. SEC* that an administrative law judge ("ALJ") of the Securities and Exchange Commission is an "Officer[]" of the United States" under the Constitution, and therefore his appointment must satisfy the Appointments Clause before he can hear or decide cases.¹ Accordingly, the Supreme Court reversed the Court of Appeals for the D.C. Circuit, which had agreed with the Commission that its ALJs are employees rather than officers, and thus not subject to the Appointments Clause. In doing so, the Supreme Court resolved a recent circuit split on this issue, but also significantly unsettled, at least in the near term, the ability of federal agencies like the Commission to adjudicate cases administratively. Indeed, the SEC has already suspended all administrative proceedings in the wake of the decision, and practitioners before the SEC and other federal agencies would be well advised to examine the *Lucia* decision to determine whether and how their rights have been affected.

Background

The Appointments Clause states, in relevant part, "the Congress may by Law vest the Appointment of such inferior Officers . . . in the President alone, in the Courts of Law, or in the Heads of Departments." Art. II, §2, cl. 2. Relying on the Appointments Clause, Raymond Lucia and his investment company challenged the validity of a decision rendered against him and his company by ALJ Cameron Elliot in an administrative proceeding instituted by the Commission. While there

¹ *Lucia v. SEC*, 595 U.S. __ (2018).

was no dispute that the Commission qualified as a "Head[] of Department[]" under the Appointments Clause, the Commission had not appointed its ALJs. Instead, the Commission had delegated these appointments (including Judge Elliot's appointment) to the Commission's staff. For that reason, Lucia argued on appeal to the Commission that Judge Elliot's appointment violated the Appointments Clause, and that he therefore had no authority to decide Lucia's case.

Not surprisingly, the Commission rejected Lucia's argument that its ALJs constituted "Officers of the United States" subject to the Appointments Clause, and instead classified its ALJs as "mere employees." In 2016, a panel of the D.C. Circuit agreed with the Commission. The D.C. Circuit granted rehearing en banc, but deadlocked, resulting in denial of Lucia's claim. In the meantime, the Court of Appeals for the Tenth Circuit issued a decision arriving at the opposite conclusion.² Soon enough, Lucia's appeal found its way to the Supreme Court, where the sole question presented was whether the Commission's ALJs are "Officers of the United States" or mere employees of the Federal Government.

Justice Kagan's Majority Opinion in *Lucia*³

Justice Kagan's majority opinion distinguished between officers and employees on two attributes: first, permanence - an officer occupies a "continuing" position established by law⁴; and second, influence – an officer exercises "significant authority pursuant to the laws of the United States."⁵ Based on these criteria, Justice Kagan reasoned that the Court's decision was controlled by the analysis in *Freytag v. Commissioner*, 501 U.S. 868 (1991).

In *Freytag*, the Supreme Court ruled that special trial judges ("STJs") of the U.S. Tax Court are officers, not mere employees. Among other things, the Supreme Court pointed out in *Freytag* that STJs hold a "continuing office" and perform "important functions" with "significant discretion." Specifically, STJs "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders."

Justice Kagan held that the Commission's ALJs share these characteristics with the STJs in *Freytag*. Thus, *Freytag* "says everything necessary to decide this case." Moreover, Justice Kagan observed that ALJs enjoy greater autonomy than *Freytag*'s STJs, because decisions by an ALJ are not subject to mandatory review the way that some STJ decisions are. Unlike STJs, the Commission's ALJs possess a "last-word capacity," reinforcing Justice Kagan's conclusion, *a fortiori*, that ALJs exercise the requisite "significant authority" within the meaning of *Buckley v. Valeo* to be officers rather than employees.

² *Bandimere v. SEC*, 844 F.3d 1168, 1179 (10th Cir. 2016).

³ The 7-2 vote in the case masks the number of competing positions advanced by the various Justices. This overview focuses on Justice Kagan's majority opinion and its potential ramifications. Justice Kagan's majority opinion was accompanied by: (1) a concurrence from Justice Thomas (joined by Justice Gorsuch) agreeing with the result, but arguing that the decision should have been guided by the "original public meaning" of the phrase "Officers of the United States," under which virtually any federal employee would qualify as an officer; (2) a concurrence in part and a dissent in part from Justice Breyer (joined by Justices Ginsburg and Sotomayor only as to part of the dissent) arguing that the outcome was correct but should have been decided on statutory grounds, and that there was no need to reach the constitutional issue; and (3) a dissent from Justice Sotomayor (joined by Justice Ginsburg) arguing that Commission ALJs are not officers for purposes of the Appointments Clause.

⁴ *Lucia* (quoting *United States v. Germaine*, 99 U.S. 508, 511-12 (1897))

⁵ *Lucia* (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976)).

Thus, in succinct and straightforward fashion, Justice Kagan concluded that Judge Elliot's appointment had been unconstitutional. Lucia's remedy would be a new hearing before a properly appointed official to cure the constitutional error, with one major wrinkle: Justice Kagan added that Judge Elliot could not hear the case again. Having issued an initial decision on the merits, the Justice reasoned, Judge Elliot could not be expected to consider the matter anew. Notably, in ruling that Lucia was entitled to a do-over, Justice Kagan observed that Lucia had made "a timely challenge" by contesting the validity of Judge Elliot's appointment before the Commission, suggesting that the constitutional error can be waived if not raised in the first instance before the ALJ.⁶

The Potential Reach of *Lucia*

The impact of *Lucia* on the Commission's administrative adjudicative process will unfold quickly in the coming months, and likely disrupt the Commission's ability to pursue its cases before ALJs in the near term. In November 2017, while the petition for certiorari in *Lucia* was pending before the Supreme Court, the Commission attempted to address proactively an adverse decision by issuing an Order purporting to ratify the prior appointments of its ALJs.⁷ The Ratification Order also identified 101 pending cases in which an ALJ had already issued an initial decision, and remanded each of those cases, as well as all other cases pending before an ALJ, for reconsideration. Now that Justice Kagan's majority opinion bars Judge Elliot from rehearing the case, however, the Commission will likely face, at minimum, the unenviable task of reshuffling the ALJs on these pending 101 cases to ensure that a new ALJ rehears the case.

Although the Supreme Court expressly declined to address whether the Ratification Order cured the constitutional error, Justice Kagan's majority opinion hinted in a footnote that an ALJ "whose claim to authority rests on the ratification order" may not pass muster. Thus, the validity of the Commission's effort to ratify the prior appointment of its existing ALJs with the stroke of a pen could also be suspect. The Appointments Clause may well demand more process and oversight.⁸ Plainly, the Commission will have to revisit its Ratification Order, and it will have to quickly implement a new process of appointing its ALJs to conform with *Lucia*.

Until the Commission cures its appointment process, any litigants with cases still pending before the Commission who have challenged (or will challenge) the constitutionality of their ALJ's appointments will likely demand a new hearing under *Lucia*.

⁶ Justice Kagan cited *Ryder v. United States*, 515 U.S. 177, 182-83 (1995), to support the conclusion that Lucia had made a timely challenge. The *Ryder* court specifically noted the petitioner had challenged the composition of the Coast Guard Court of Military Review while his case was pending before that court on direct review.

⁷ See Order, *In re: Pending Administrative Proceedings*, Securities Act Release No. 110440 (Nov. 30, 2017), available at: <https://www.sec.gov/litigation/opinions/2017/33-10440.pdf>

⁸ This issue could arise in a future case. Justice Kagan's majority opinion expressly declined to address the concomitant question of whether the statutory restrictions on removing the Commission's ALJs are constitutional, preferring to defer the question to another day, despite the U.S. Solicitor General twice requesting the Supreme Court address it during the briefing for *Lucia*. Justice Breyer was the lone justice to address this question, and his concurrence and dissent illustrate the deeper dilemma in light of the Supreme Court's prior precedent: if ALJs are officers under the Appointments Clause, restrictions on their removal by the Commission – restrictions intended to promote an ALJ's independence and legitimacy - may be unconstitutional.

Concern in the Administrative State

Moreover, the impact of *Lucia* will also continue to reverberate beyond the Commission and reach other parts of the administrative state given the constitutional grounds of Justice Kagan's majority opinion.

For example, in April 2018, the Commodities and Futures Trading Commission (CFTC) attempted to address the potential effects of *Lucia* by issuing its own Order ratifying the appointment of its Judgment Officer (the CFTC's version of an ALJ), and ordered reconsideration of all of its pending cases.⁹ The decision in *Lucia* now casts doubt on the validity of the CFTC's ratification order. And, Appointments Clause challenges have been litigated in the last two years against ALJs at the Consumer Financial Protection Bureau and the Federal Deposit Insurance Corporation.¹⁰ *Lucia* will likely spur further litigation in the same vein. Other agencies with administrative judges, to the extent their appointments are similarly susceptible to constitutional challenge under *Lucia*, may be vulnerable.¹¹

In the meantime, counsel for respondents in administrative proceedings before the Commission and other administrative agencies would do well to study *Lucia* and consider whether a challenge under the Appointments Clause is appropriate.

⁹ See Ratification and Reconsideration Order, *In re: Pending Administrative Proceedings* (April 9, 2018), available at: <https://www.cftc.gov/sites/default/files/2018-04/ogcorder040918.pdf>.

¹⁰ The D.C. Circuit, sitting en banc, declined to address an Appointments Clause challenge to an ALJ at the Consumer Financial Protection Bureau, but relied on its prior en banc decision in *Lucia v. SEC*, which has now been reversed. See *PHH Corp. v. Consumer Financial Protection Bureau*, 881 F.3d 75, 83, 201-02 (D.C. Cir. 2018).

An Appointments Clause challenge to an ALJ at the Federal Deposit Insurance Corporation is also before the Fifth Circuit, and the Fifth Circuit has stayed the ALJ order at issue pending the appeal. See *Burgess v. Federal Deposit Insurance Corporation*, No. 17-60579, Motion to Stay Order of Federal Deposit Insurance Corporation's Board of Directors Pending Final Decision on Petition for Review (5th Cir., Sept. 7, 2017), available at: <http://www.ca5.uscourts.gov/opinions/pub/17/17-60579-CV0.pdf>.

¹¹ Justice Breyer's concurrence and dissent is instructive on this score. In urging *Lucia* should have been decided on statutory grounds based on the canon of constitutional avoidance, Justice Breyer pointed out that the Securities and Exchange Act permitted the Commission to delegate its functions to its Staff, but the Commission had not adhered to the Act's requirement of a "published order or rule" in delegating the appointment of its ALJs. Thus, whether other agencies have constitutionally defective appointments for its administrative judges may require a case-specific analysis.

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