Securities Litigation Update: After Full D.C. Circuit Deadlocks, Circuit Court Split over the Constitutionality of SEC Administrative Law Judges Likely Bound for Supreme Court

June 28, 2017

On June 26, 2017, the full D.C. Circuit Court of Appeals split down the middle **over whether the Securities and Exchange Commission's (the "SEC's") appointment of Administrative Law Judges ("ALJs") is consistent with the Constitution. As detailed in a** prior alert**, panels of the Tenth and D.C. Circuit Courts of Appeals had previously come to opposite conclusions in response to constitutional challenges to the SEC's appointment of ALJs. These challenges, described in detail** here**, have contended that ALJs are inferior officers who were not appointed according to the Appointments Clause in Article II of the Constitution. The issue initially appeared settled when the D.C. Circuit held in *Lucia v. SEC*[1] that ALJs were not officers subject to the requirements of the Appointments Clause. But, on December 27, 2016, the Tenth Circuit decided in *Bandimere v. SEC*[2] that ALJs were indeed inferior officers and therefore were in violation of the Appointments Clause. On May 3, 2017, the Tenth Circuit declined to rehear *Bandimere en banc*. The D.C. Circuit, however, decided to rehear *Lucia en banc* and the full D.C. Circuit heard oral argument on May 24, 2017. Only weeks after argument, the D.C. Circuit announced that it could not form a majority opinion on the answer to the constitutional question. Accordingly, the *Lucia* decision, which upheld the appointment of SEC ALJs, remains in force. Now that the *en banc* dust has settled and the split between the Tenth and D.C. Circuits has solidified, the constitutionality of SEC ALJs' appointment appears headed for the Supreme Court.**

The Constitutional Challenge

The Appointments Clause provides that the President shall appoint officers of the United States, but that Congress may vest the appointment of inferior officers "in the President alone, in the Courts of Law, or in the Heads of Departments." In *Bandimere* and *Lucia*, securities law defendants argued that SEC ALJs are inferior officers, and because SEC ALJs are not appointed by SEC Commissioners, the President, or a court, they have been appointed in violation of the Appointments Clause.

The D.C. Circuit Panel Sides with the SEC

The question presented by these challenges is whether ALJs are inferior officers, whose appointments are subject to the requirements of the Appointments Clause, or simply employees. In *Lucia*, the D.C. Circuit reasoned that one key difference between an inferior officer and an employee is that inferior

[1] 832 F.3d 277 (D.C. Cir. 2016).

[2] No. 15-9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016).

officers have "final decision-making power." On this point, the D.C. Circuit was bound by its prior ruling in *Landry v. FDIC*,[3] which held that the Federal Deposit Insurance Corporation's ("FDIC's") ALJs were not inferior officers because they could not issue final decisions. Having previously emphasized that an official's ability to render final decisions was "critical" to the inferior officer inquiry, the D.C. Circuit found that because ALJs do not have final decision-making power, they were not inferior officers subject to the Appointments Clause.

The Tenth Circuit Panel Sides with Securities Defendants

In a split decision, the Tenth Circuit disagreed with the D.C. Circuit's position that final decision-making authority was a prerequisite for inferior officer status. Instead, it reasoned that the Supreme Court's decision in *Freytag v. Commissioner of Internal Revenue*,[4] which held that Tax Court special trial judges ("STJs") were inferior officers, did not depend on whether STJs had final decision-making authority: The Supreme Court "did not make final decision-making power the essence of inferior officer status." Following *Freytag*, the Tenth Circuit held that SEC ALJs were inferior officers because they hold duties comparable to the STJs in *Freytag* and because ALJs "exercis[e] significant authority pursuant to the laws of the United States."

The Tenth Circuit Declines Rehearing *En Banc*, and the Full D.C. Circuit Is Deadlocked

On May 3, 2017, the full Tenth Circuit declined to rehear *Bandimere*. Two judges, however, wrote a long dissent arguing that the Tenth Circuit should rehear the case and rule for the SEC: "In light of the significant consequences of this decision, it is not our office to expand the holding in *Freytag*, to the contrary, any such expansion should remain in the sole discretion of the Supreme Court."

The D.C. Circuit, for its part, decided to rehear *Lucia en banc* and heard oral argument on May 24, 2017. Only weeks after hearing argument, however, the Court issued a one-page opinion stating that the petition for *en banc* review "is denied by an equally divided court." The panel decision in *Lucia*, which ruled for the SEC, therefore remains in full effect.

The Supreme Court Will Likely Decide

The question presented by *Bandimere* and *Lucia* is primed for Supreme Court review. There is now a clear split on a constitutional question that only the Supreme Court may resolve. In the meantime, the constitutionality of the appointment of ALJ's at the SEC and potentially other agencies as well – and the actions those ALJs have taken – remains uncertain.

---

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

[4] 501 U.S. 868 (1991).

Davis Polk

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

New York		
Greg D. Andres	**212 450 4724**	**greg.andres@davispolk.com**
Martine M. Beamon	**212 450 4262**	**martine.beamon@davispolk.com**
Angela T. Burgess	**212 450 4885**	**angela.burgess@davispolk.com**
Michael S. Flynn	**212 450 4766**	**michael.flynn@davispolk.com**
Avi Gesser	**212 450 4181**	**avi.gesser@davispolk.com**
Jennifer G. Newstead	**212 450 4999**	**jennifer.newstead@davispolk.com**
Amelia T.R. Starr	**212 450 4516**	**amelia.starr@davispolk.com**
James H.R. Windels	**212 450 4978**	**james.windels@davispolk.com**
Menlo Park		
Neal A. Potischman	**650 752 2021**	**neal.potischman@davispolk.com**
Washington DC		
Linda Chatman Thomsen	**202 962 7125**	**linda.thomsen@davispolk.com**