

## Supreme Court Holds that SEC Administrative Law Judges Have Been Unconstitutionally Appointed in Decision that is Likely to Have Far-Reaching Impact

June 25, 2018

The Supreme Court's opinion in *Lucia v. SEC*,<sup>1</sup> holding that SEC ALJs qualify as Officers of the United States under the Constitution and are therefore subject to the Appointments Clause of the Constitution, is likely to have far-reaching consequences for other federal agencies that rely on ALJs. Any federal agency that appoints ALJs in a manner similar to the SEC is now vulnerable to similar constitutional challenges under the Appointments Clause. Further, while *Lucia* resolved one constitutional challenge to ALJs, a concurrence by Justice Breyer highlights another significant constitutional question: whether the statutory removal protections afforded to SEC ALJs are also unconstitutional. Accordingly, *Lucia* presents a number of open questions, including whether the decision can be used to reopen past ALJ adjudications at the SEC or elsewhere, how it will impact existing ALJs and the ALJ appointment process at other federal agencies, and whether ALJs can survive a separate constitutional challenge to their removal protections.

### The Potential Implications for Retroactive and Future Challenges to ALJ Decisions Are Numerous

In this client alert, we first analyze the implications of the Court's decision, then describe the Court's reasoning and Justice Breyer's concurrence, and, finally, address the unanswered questions raised by the *Lucia* decision.

We believe that the potential implications for retroactive and future challenges based on the *Lucia* decision are numerous. First, because SEC ALJ appointments were unconstitutional, many respondents will seek to open prior SEC ALJ adjudications on the basis that the presiding ALJ was unconstitutionally appointed. The *Lucia* opinion emphasized that Raymond Lucia was entitled to a rehearing because he timely challenged the constitutionality of the ALJ's appointment at every stage of his proceedings, indicating that respondents who raised timely constitutional challenges may be able to re-open closed ALJ proceedings. It is less clear whether those who failed to assert such a challenge will be able to revisit closed cases, though we expect that many respondents will try.

Second, Justice Breyer's concurrence raises the question whether the removal protections applicable to SEC ALJs are unconstitutional. While the majority declined to reach this question, Justice Breyer's opinion provides respondents with an independent constitutional challenge to SEC ALJs based on their multi-level removal protections. As a practical matter, we expect that at the least the SEC will hesitate to try contested actions before its ALJs because of the open question regarding the constitutionality of their removal protections; accordingly, we may see many more contested actions brought by the SEC in

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<sup>1</sup> Slip Op., No. 17-130 (June 21, 2018).

federal district court as opposed to its administrative forum.

Finally, and perhaps most significantly, the Court's ruling in *Lucia* will impact administrative law judges in other federal agencies to the extent that their hiring, tenure, and authority match that of the SEC ALJs. To the extent that other agencies employ ALJs appointed by agency staff rather than by the President, a court, or the head of the agency, those ALJs are subject to constitutional challenge and the outcome of prior and pending adjudications by such ALJs will be in question. During oral argument, Lucia's counsel asserted that there are approximately 150 ALJs who decide adversarial proceedings in at least 25 different agencies.<sup>2</sup> It will take some time to sort out which agencies are most affected and for those agencies to decide what to do regarding their ALJ appointment process.

As a harbinger of possible future constitutional challenges, we list below some of the key agencies where there has been public action or commentary on this issue.

- **FDIC, Federal Reserve, OCC.** The Fifth Circuit recently held that an FDIC respondent had made a strong showing that FDIC ALJs, which exercise many of the same responsibilities as SEC ALJs, are "officers" of the United States and not appointed in accordance with the Appointments Clause.<sup>3</sup> Given that the Fifth Circuit's analysis closely tracked the Supreme Court's analysis in *Lucia*, challenges to the FDIC ALJs have a good chance of succeeding. Similar challenges are likely to be brought against the ALJs who hear administrative proceedings for the Federal Reserve and OCC.
- **CFPB.** CFPB ALJs have powers similar to SEC ALJs and are subject to the same arguments regarding their status as constitutional officers. Commentators have also noted that the CFPB, which is established as an agency within the Federal Reserve System, may not be considered a "Department" under the Appointments Clause.<sup>4</sup> Accordingly, there may be a question as to whether the Director of the CFPB is constitutionally capable of appointing an ALJ.
- **CFTC.** After the Solicitor General agreed with Lucia that SEC ALJs were not appointed consistent with the Constitution, the CFTC issued an April 6, 2018 [order](#) explaining that it does not employ ALJs. The CFTC does employ a "Judgment Officer," which may or may not be an Officer of the United States under the Constitution. Out of an abundance of caution, the CFTC ratified the Judgment Officer's appointment and ordered the Judgment Officer to reconsider prior actions in pending cases and to reconsider two prior actions that had been decided. Accordingly, the *Lucia* proceeding is unlikely to impact CFTC proceedings before the Judgment Officer going forward, unless the same Judgment Officer who decided the original case also reheard the case after the constitutional flaw in his or her original appointment was cured.

### Lucia's Constitutional Challenge

The constitutional basis for Lucia's challenge was the Appointments Clause, which requires that "inferior officers" of the United States be appointed by the President, a court, or a department head.<sup>5</sup> SEC ALJs, however, were appointed by SEC staff members. Lucia argued that SEC ALJs are inferior officers within

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<sup>2</sup> April 23, 2018 Tr. 9:12-22.

<sup>3</sup> *Burgess v. FDIC*, No. 17-60579 (5th Cir. 2017).

<sup>4</sup> See, e.g., Kent Barnett, *The Consumer Financial Protection Bureau's Appointment With Trouble*, 60 Am. U. L. Rev. 1459 (2011).

<sup>5</sup> Art. II, § 2, cl.2.

the meaning of the Appointments Clause and that, because the ALJ who heard his case was not appointed by the Commission, the President, or a court, the ALJ's appointment was unconstitutional. The government initially contested Lucia's position, arguing that SEC ALJs are mere "employees" and are not subject to the Appointments Clause. However, as discussed in a previous [alert](#), after the election of President Trump, the government switched sides before the Supreme Court and agreed with Lucia's position that SEC ALJs were unconstitutionally appointed.

## **The Court Holds that SEC ALJs Were Unconstitutionally Appointed Because They Are Officers of the United States and Were Not Appointed in Compliance with the Appointments Clause**

In this section, we describe the Court's majority opinion, which was authored by Justice Kagan. As is often the case in separation of powers cases, the lineup of the Justices does not fall neatly into conservative or liberal labels.<sup>6</sup> The Court first reviewed the standards for distinguishing between inferior officers of the United States, who must be appointed consistent with the Appointments Clause, and mere employees, who fall outside of the Clause's reach. To be such an officer, a person must (i) have "continuing and permanent" duties; and (ii) "exercise[] significant authority pursuant to the laws of the United States." Although the Court acknowledged that the "significant authority" standard is "framed in general terms," it found it unnecessary to elaborate on that standard in this case because, according to the views of a majority of the Justices, the Court's decision in *Freytag v. Commissioner*<sup>7</sup> dictated that SEC ALJs are officers of the United States under the Constitution.

*Freytag* held that special trial judges of the United States Tax Court ("STJs") exercised significant authority and were thus constitutional officers because, among other things, STJs could take testimony, conduct trials, and enforce compliance with discovery orders. That STJs could not issue final decisions, but only made proposed findings for adoption by a Tax Court Judge, did not change the analysis.

In *Lucia*, the Court reasoned that "[i]f the Tax Court's STJs are officers, as *Freytag* held, then the Commission's ALJs must be too" because ALJs receive a "lifetime" career appointment and exercise the same, if not more, authority as STJs. Like STJs, ALJs make evidentiary rulings, conduct trials, regulate the conduct of parties, and enforce discovery rulings. Further, while ALJs may propose findings for the Commission to adopt, if the Commission declines to review those findings (which it often does), the ALJ's findings are final. Accordingly, the Court held that SEC ALJs are constitutional officers.

After noting that Lucia had "timely challenge[d]" and "contested the validity" of the SEC ALJ's appointment at every stage of his case, the Court ordered that he receive a new hearing. It also held that the new hearing had to be before a new, constitutionally-appointed SEC ALJ on remand because the original ALJ "cannot be expected to consider the matter as though he had not adjudicated it before."<sup>8</sup>

## **Justice Breyer's Separate Opinion Highlights an Independent Constitutional Question**

In a separate concurring opinion, Justice Breyer argued that the case should have been decided on statutory, rather than constitutional, grounds. According to Justice Breyer, the Administrative Procedure

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<sup>6</sup> Justice Kagan delivered the opinion of the Court, which was joined by Chief Justice Roberts and Justices Kennedy, Thomas, Alito, and Gorsuch. Justice Thomas filed a concurring opinion that was joined by Justice Gorsuch, and Justice Breyer filed an opinion concurring in the judgment in part and dissenting in part, in which Justices Ginsburg and Sotomayor joined as to the final section. Justice Sotomayor filed a dissenting opinion that was joined by Justice Ginsburg.

<sup>7</sup> 501 U.S. 868 (1991).

<sup>8</sup> Justice Breyer disagreed that Lucia's case had to be reassigned to a different ALJ on remand, noting that the reversal "implies no criticism at all of the original judge or his ability to conduct the new proceedings."

Act (“APA”), which confers authority on federal agencies to appoint ALJs, does not permit the SEC to delegate its appointment power to members of its staff—rather, the power to appoint ALJs rests solely with “the Commission itself.” Justice Breyer therefore concluded that the SEC’s ALJ appointments were invalid because they were not made by “the Commission itself,” as required by the APA, or pursuant to a published rule or order, as required by the SEC’s enabling statute.

Justice Breyer also highlighted an additional constitutional question: whether the APA provision establishing “for cause” removal protection for ALJs is unconstitutional under the Supreme Court’s decision in *Free Enterprise Fund v. Public Accounting Oversight Board*.<sup>9</sup> In *Free Enterprise Fund*, the Court held that providing PCAOB members with multiple layers of protection from removal without cause by the President impermissibly interfered with the President’s executive authority. In reaching this conclusion, the Court emphasized that members of the PCAOB were “inferior officers” for purposes of the Appointments Clause. Thus, as Justice Breyer explains, and as the Solicitor General’s briefing on this issue suggested, the majority’s holding that ALJs qualify as “inferior officers” under the Constitution raises similar concerns regarding whether the “for cause” removal protection afforded to ALJs under the APA is also unconstitutional.

### A Number of Open Questions Remain After *Lucia*

There are a number of practical questions for companies and individuals that have been or will be respondents in administrative proceedings before ALJs:

- **Will respondents’ motions to reopen past proceedings succeed?** The majority opinion in *Lucia* appears to require that a respondent seeking to re-open its case on the basis of the *Lucia* holding have timely raised that constitutional challenge during the original proceeding. Nonetheless, we expect that a number of respondents will seek to reopen their cases despite having never raised a constitutional challenge during their proceedings, though such efforts may ultimately be unsuccessful.
- **Will respondents raise constitutional challenges across administrative agencies?** Given the breadth of the *Lucia* opinion and the number of serious constitutional questions raised, we expect respondents to raise constitutional challenges in ALJ proceedings across administrative agencies. Even if certain agencies’ appointment processes are distinguishable from those of the SEC, and even if other agencies attempt to cure any Appointment Clause issues, there is little downside to respondents raising these challenges.
- **Can administrative agencies cure any constitutional defect?** As described in a past [alert](#), the SEC attempted to cure its appointment problem in November 2017 by “ratifying” the prior appointments of its ALJs. Although it did not address whether that ratification cured any defect, the Court suggested that only a properly appointed ALJ may decide cases. Even so, the head of an agency may officially appoint ALJs, and that appointment will cure any Appointments Clause issue going forward, unless the same ALJ who decided the original case also reheard the case after the constitutional flaw in his or her original appointment was cured. Indeed, the SEC has appointed its ALJs since the end of last year. A larger question regarding the constitutionality of ALJs given their removal protections is raised by Justice Breyer’s concurring opinion, and it is unclear whether agencies can cure that potential constitutional issue without stripping ALJs of those protections.

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<sup>9</sup> 561 U.S. 477 (2010).

- **How will individuals be impacted?** The constitutional challenges raised in *Lucia* do not depend on the nature of the respondent. However, most contested proceedings brought by the SEC and many other agencies in the administrative forum involve individuals. Further, given that the Social Security Administration employs the largest number of ALJs, the *Lucia* ruling is likely to impact individuals on a wide scale if the hiring, tenure and authority of these ALJs are sufficiently similar to those of the SEC ALJs.

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