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Lucia: The End of SEC ALJs?

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The Supreme Court resolved the question of whether SEC ALJs must be appointed in accord with the Constitution's Appointments Clause, holding that their retention is subject to the provision. Thus the Court held that Petitioner Raymond J. Lucia is entitled to a new hearing before a different ALJ appointed in accord with the Constitution. *Raymond J. Lucia, vs. Securities and Exchange Commission*, No. 17-130 (June 21, 2018). The Court's ruling leaves unresolved, however, more issues than it resolved concerning the constitutionality of ALJs, the appropriate remedies for a violation of the Clause and ultimately the question which sparked the controversy that resulted in the case – venue selection for SEC enforcement actions. Indeed, in the wake of the Court's decision, the SEC ordered a halt to all of its administrative proceedings for thirty days or until further ordered. The Order was entered on June 23, 2018.

The Court's opinion

The Court's ruling is a straight forward application of *Frytag v. Commissioner*, 501 U.S. 869 (1991). The Constitution's Appointments Clause, Article II, §2, Cl. 2, provides that only the President, a court of law, or a head of a department can appoint Officers of the United States. The question considered by the Court is whether SEC ALJs are Officers within the meaning of the clause. Those who are must be appointed in accord with the Clause, here by the SEC since it is considered a department head for this purpose.

Two prior decisions by the Court provided the guideposts for resolving this question, according to the opinion authored by Justice Kagan and joined by six other Justices. First, in *U.S. v. Germaine*, 99 U.S. 508 (1879) the Court found that civil surgeons – doctors

retained to perform certain exams – held "temporary rather than continuing and permanent" positions. The position must be established by law. Temporary positions were deemed not sufficient.

Second, *Buckley v. Valeo*, 424 U.S. 1 (1976)(*per curiam*) held that members of a federal commission were Officers within the meaning of the Clause after concluding that they exercised "significant authority" under the laws of the United States. While the "significant authority" test requires an analysis of the powers exercised by the person and may need refinement as urged by *amicus* who defended the decision below following the confession of error by the Solicitor General who joined with Petitioner in challenging the ALJ appointment here, that is not required now, according to the Court. This is because in *Frytag* "we applied the unadorned 'significant authority' test to adjudicative officials who are near-carbon copies of the Commission's ALJs." *Frytag* "says everything necessary to decide this case."

Frytag considered whether special trial judges at the Tax Court were Officials under the Clause. The authority of those judges was a function of the matter before them. In major matters, they would preside over the hearing and prepare findings and an opinion for a regular Tax Court judge. The STJs could not issue the final ruling. For other matters the STJs could issue a final ruling.

The case in *Frytag* involved a major matter. The Court held that the STJs were in fact Officers for purposes of the Appointments Clause. The ruling is based on two key considerations. First, citing *Germaine*, the Court found that the positions were established by law and permanent. Second, following *Buckley*, the Court concluded that the position requires the exercise of significant authority. This is because STJs were required to take testimony, conduct trials, rule on the admissibility of evidence and enforce compliance with discovery orders. Carrying out those obligations requires the exercise of significant authority. The fact that in the major case before the Court the STJ could not enter the final decision was not dispositive. Rather, the Court found that STJs were Officers under the Appointments Clause. Since it is undisputed that SEC ALJs have virtually identical authority, they are Officers and must be appointed in accord with the Clause. Although there are some differences between the authority of an SEC ALJ and an STJ as amicus argued, they are not significant and do not detract from the conclusion that *Frytag* resolves this case.

The appropriate remedy for "an adjudication tainted with an appointments violation is a new 'hearing before a properly appointed' official," the Court concluded. In this regard, the Court held that the SEC ALJ who presided over the initial hearing cannot conduct the new proceeding even if properly appointed. This is because the remedies in these cases are designed in part to create incentives for persons to present these challenges and those are aided by directing that a different, properly appointed official, preside at the new hearing. Accordingly, to "cure the constitutional error, another ALJ (or the Commission itself) must hold the new hearing to which *Lucia* is entitled." The Court declined to consider the validity of the SEC's November 30, 2017 order that sought to "ratify" the appointment of its ALJs.

Justice Thomas, joined by Justice Gorsuch, concurred. In his opinion, the Justice noted that the Court's opinion discusses what is "*sufficient* to make someone an officer of the United States, [but] our precedents have never clearly defined what is *necessary*." (emphasis original). "To the Founders, this term [Officer] encompassed all federal civil officials with responsibility for an ongoing statutory duty." (Internal citations omitted). Viewed in this context SEC ALJs "easily qualify as 'Officers of the United States' . . . the importance or significance of their statutory duties is irrelevant..."

Justice Breyer concurred in the judgment but dissented in part in an opinion joined by Justices Ginsburg and Sotomayor. While Justice Breyer agrees that the SEC did not properly appoint its ALJs, the case should have been resolved on statutory grounds and the constitutional issue avoided since its resolution was unnecessary.

This case could be resolved by considering the dictates of the Administrative Procedure Act or APA. That statute, enacted in 1946, provided in part that each agency could retain as many Administrative Law Judges as necessary for hearings governed by the Act. That Act does not provide that the Commission can simply delegate its power to appoint its administrative law judges to the staff. The APA requires a published order or rule for delegation. Here the SEC did not publish such an order or rule. Its effort to delegate the authority to hire ALJs to its staff is thus invalid.

A second reason for avoiding the constitutional issue stems from the Court's prior ruling in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010). That case considered the statutory provisions protecting members of the PCAOB from removal without cause. There the "Court held that the Executive Vesting Clause of the Constitution, Art. II, §1 ('[t]he executive Power shall be vested in the President of the United States of America'), forbade Congress from providing members of the board with multilevel protections from removal' by the President," quoting *Free Enterprise Fund*, 561 U.S. at 484. This is because Congress cannot limit the authority of the President by providing two levels of employment protection. In resolving this question the Court stated that members of the Board are Officers of the United States, although the "significance of that fact to the Court's analysis is not entirely clear," according to Justice Breyer.

The APA also provides protections from removal for ALJs. Those provisions were viewed as important parts of the APA since they provided them with insulation from the political processes. This is because prior to the Act, hearing officers were subject to their agency which created issues regarding their independence.

"If the *Free Enterprise Fund* Court's holding applies equally to the administrative law judges – and I stress the 'if' – then to hold that the administrative law judges are 'Officers of the United States' is, *perhaps*, to hold that their removal protections are unconstitutional. This would risk transforming administrative law judges from independent adjudicators into *dependent* decision makers, serving at the pleasure of the Commission." (emphasis original). At the same time, the Court in *Free Enterprise* "disagreed [with my dissent stating this point] saying that 'none of the positions" such as ALJs identified in the dissent are "similarly situated to the Board."

Viewed in this context, a holding that ALJs are Officers could come into conflict with the *Free Enterprise Fund's* limitation on the "for cause" protections from removal. In that event, the decision of Congress to provide those protections would be called into question. Yet under the Appointments Clause Congress' intent is important. Its determination on this point would suggest that in fact, SEC ALJs are not Officers as the Court ruled. It is because of these issues that the Solicitor General urged the Court to consider this question. The Court declined.

Finally, there is no reason that the new hearing ordered in this case has to be presided over by a different ALJ, according to Justice Breyer.

Justice Sotomayor dissented in an opinion joined by Justice Ginsburg. The Court's jurisprudence in this area offers little guidance, the Justice noted. "To provide guidance to Congress and the Executive Branch, I would hold that one requisite component of 'significant authority' is the ability to make final, binding decisions on behalf of the Government. Accordingly, a person who merely addresses and provides recommendations to an officer would not herself qualify as an officer." While SEC ALJs have "extensive powers," "I would hold that Commission ALJs are not officers because they lack final decision-making authority." In addition, "I share Justice Breyer's concerns regarding the Court's choice of remedy..."

Comment

Lucia resolves the one question the Court agreed to hear in granting *certiorari*. It leaves unresolved, however, more questions than it actually resolves, ultimately casting a pall of uncertainty over the Commission's administrative hearing process that undoubtedly will spawn more litigation. It could be years before the ultimate validity of SEC ALJ's is resolved.

To be sure, the Court did, in fact, resolve the question of whether the Commission's ALJs must be appointed in accord with the dictates of the Constitution's Appointments Clause. SEC ALJs are in fact Officers within the meaning of the Appointments Clause the Court concluded. Therefore they must be appointed by the Commission. If there was any doubt that simply directing the staff to hire the ALJs is not permissible, Justice Breyer's opinion puts the question to rest. Indeed, that procedure seems to undercut the very purpose of the APA as detailed by the Justice which, in part was to try and separate and insulate the hearing process to help ensure fairness. Permitting the staff to select the ALJs while having the staff prosecute the hearings over which they preside is more than the appearance of unfairness in a system already tinged with questions about due process.

In resolving the Appointments Clause question the Court refused to consider the related question presented by the Solicitor General and Justice Breyer regarding the employment protections afforded SEC ALJs under the APA in view of *Free Enterprise Fund*. As Justice Breyer points out, *Free Enterprise Fund* at least suggests that PCAOB members are in fact Appointment Clause Officers, although that determination was not crucial to the holding of the case. If in fact, that suggestion is correct then it would indicate that the APA employment protections afforded to SEC ALJs are contrary to the dictates of the Constitution's Vesting Clause. That suggestion, however, is at odds with the statement in *Free Enterprise Fund* that it's holding does not impact ALJs. At the same time, the fact that Congress provided those protections to ALJs seems to undercut the Court's conclusion in *Lucia* as well as *Freytag*. It was to avoid this difficulty that the Solicitor General, as well as Justice Breyer and those who joined his opinion, urged the Court to consider the question along with the Appointments Clause issue.

The Court also specified the remedy for Petitioner. That question received no attention in the lower court and little in the briefing process. In doing so it sidestepped the issue of ratification presented by the SEC's November 2017 order. Whether that process constitutes a proper remedy for what has been held to be a clear constitutional error is thus an open question.

Finally, the critical question which launched *Lucia* and a host of other similar cases is not even mentioned – venue. It was the Commission's decision to largely move its enforcement actions "in-house" rather than filing cases in federal district court which spawned *Lucia* and a number of other cases challenging those decisions. Thus, while Mr. Lucia and his firm "won" in terms of the case, after years of litigation they are no closer to their actual goal. It is perhaps the ultimate irony of the case that while Petitioners sought to escape a hearing in front of an administrative law judge by "winning" they now have the right to a new hearing before another administrative law judge.

Viewed in this context *Lucia* presents the ultimate "ground hog day" experience – an opportunity to go round and round to nowhere. The venue selection issue which launched *Lucia* has not been addressed. And, while the one issue about the Appointments Clause has been resolved, as Justice Breyer points out there are other significant questions awaiting resolution. As Justice Breyer stated, "By considering each question in isolation, the Court 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. And the Court risks doing so without considering the potential consequences." Absent an effective remedy, all future SEC administrative proceedings will be at risk which could bring about Justice Breyer's prediction. The Commission's order halting all administrative proceedings seems to acknowledge this fact.