



Supreme Court Agrees to Hear Constitutional Challenge to SEC Administrative Law Judges

Victoria L. Killion

Legislative Attorney

January 16, 2018

On Friday, the Supreme Court granted certiorari in *Lucia v. Securities and Exchange Commission (SEC)* to decide whether administrative law judges (ALJs) within the SEC are “Officers of the United States” (officers) who must be appointed in accordance with the Appointments Clause of Article II of the Constitution. If the Supreme Court holds that SEC ALJs are officers, its conclusion could call into question the validity of prior decisions rendered by SEC ALJs (whose initial hiring did not comport with the Appointments Clause) and may have broader implications for ALJs in other federal agencies. This Sidebar provides an overview of the case by first discussing the Appointments Clause and the key decisions leading up to the Court’s review, and then highlighting the relevant arguments and considerations before the Supreme Court.

Appointments Clause. The [Appointments Clause](#) provides that the President “shall nominate, and by and with the Advice and Consent of the Senate, 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.” The Constitution does not establish appointment requirements for non-officers (i.e., employees).

The central question in *Lucia* is whether SEC ALJs are inferior officers or employees, a question the Supreme Court considered with respect to special trial judges of the U.S. Tax Court in *Freytag v. Commissioner*. In *Freytag*, the Court held that special trial judges were officers rather than employees because: (1) their position is “established by Law” with statutorily prescribed duties, salary, and means of appointment; (2) the judges “perform more than ministerial tasks” in that they “take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders”; and (3) the judges “exercise significant discretion” in performing these tasks. The Court reasoned that even if the special trial judges’ duties were not so significant, the judges would still qualify as officers because they could render final decisions in certain types of cases.

Congressional Research Service

7-5700

www.crs.gov

LSB10061

As explained below, a key issue in *Lucia* is the proper interpretation of the *Freytag* decision, and in particular, whether the absence of final decisionmaking authority renders an adjudicator a mere employee.

Proceedings Below. *Lucia* began with an SEC enforcement action against an investment company and its owner (the *Lucia* Petitioners). An SEC ALJ presided over the case and rendered an initial decision concluding that the *Lucia* Petitioners had misled potential investors in presenting their “Buckets of Money” retirement investment strategy. The sanctions imposed by the ALJ included civil money penalties and a lifetime industry bar for the company’s owner. On appeal to the Commission, the *Lucia* Petitioners argued that the proceedings before the ALJ were invalid because the ALJ was not appointed in accordance with the Appointments Clause (i.e., by the President, a department head, or the courts). The Commission rejected Petitioner’s Appointments Clause challenge and, after reviewing the record, imposed the same sanctions as the ALJ.

On appeal to the D.C. Circuit, a unanimous panel ruled that SEC ALJs are not officers subject to the Appointments Clause. The court relied in key respects on its earlier decision in *Landry v. Federal Deposit Insurance Corporation (FDIC)*, in which the court held that ALJs at the FDIC are employees rather than inferior officers because they do not have the power to render final decisions for the FDIC. Two judges on the *Landry* panel had reasoned that the “power of final decision . . . was critical” to the Supreme Court’s holding in *Freytag* that special trial judges were inferior officers. The concurring judge disagreed, reasoning that the Supreme Court had cited final decisionmaking authority as an alternative basis for concluding that special trial judges are inferior officers; in other words, the other duties of special trial judges were sufficient to consider them inferior officers.

Analogizing to the *Landry* decision, the *Lucia* panel held that SEC ALJs were employees, rather than inferior officers, because an SEC ALJ’s decision becomes final only when the Commission issues a finality order declining review and stating when sanctions, if any, take effect. Following en banc review, the D.C. Circuit did not publish an opinion on the Appointments Clause issue and instead issued a short *per curiam* decision denying the *Lucia* Petitioners’ request for review of the SEC’s decision “by an equally divided court.”

Circuit Split. Following the D.C. Circuit panel decision in *Lucia*, the Tenth Circuit (and later the Fifth Circuit) interpreted *Freytag* to mean that final decisionmaking authority is relevant, but not dispositive, in considering whether an ALJ is an inferior officer. Specifically, the Tenth Circuit concluded that SEC ALJs are officers because, like the special trial judges in *Freytag*, their position, duties, salary, and means of appointment are specified by statute, and they “exercise significant discretion” in performing important adjudicatory functions.

Initial Supreme Court Filings. In their petition for a writ of certiorari, the *Lucia* Petitioners describe *Freytag* as a “critical decision” and argue that based on this and other authority, SEC ALJs are officers subject to the Appointments Clause. They submit that the Supreme Court “has never held that a federal adjudicator is a mere employee, while holding that many quasi-judicial officials—including clerks, commissioners, and non-Article III judges—are Officers.” As to the Petitioners’ proposed remedy if they prevail on their constitutional challenge, they argue that “the only appropriate remedy” is for the Court to vacate the SEC’s decision.

In the proceedings below, the SEC formerly took the position that its ALJs were employees rather than officers. However, in its response to the *Lucia* petition, the Solicitor General (as counsel of record on behalf of the government) states that “[u]pon further consideration, and in light of the implications for the exercise of executive power under Article II, the government is now of the view that [SEC] ALJs are officers because they exercise ‘significant authority pursuant to the laws of the United States.’” The Solicitor General asks the Court to appoint an amicus curiae to defend the D.C. Circuit’s judgment.

The Solicitor General also argues that whether SEC ALJs are officers has “important implications” for “the manner in which they may be removed from office,” and urges the Court to “address whether the

restrictions imposed by statute on [SEC ALJs'] removal are consistent with the constitutionally prescribed separation of powers." Specifically, the Solicitor General [submits](#) that SEC ALJs enjoy "at least two, and potentially three, levels of protection against presidential removal authority" because the Commission may remove them "only for good cause established and determined by the Merit Systems Protection Board" whose members "in turn 'may be removed by the President only for inefficiency, neglect of duty, or malfeasance in office'"—a standard which, according to the Solicitor General, may also apply to the individual Commissioners. The Solicitor General [argues](#) that the Supreme Court has "recognized that the Constitution forbids Congress from placing certain restrictions on the power to remove officers of the United States," citing *Free Enterprise Fund v. Public Company Accounting Oversight Board*, in which the Court [held](#) that "dual for-cause limitations" on the removal of Board members violated Article II. The *Lucia* Petitioners oppose review of the removal issue, [arguing](#) that it is beyond the scope of the question presented (i.e., whether SEC ALJs are officers) and was not argued or decided in the proceedings below.

SEC's Ratification Order. The day after the Solicitor General's filing in *Lucia*, the SEC issued an [order](#) ratifying "the agency's prior appointment" of its five ALJs. The order also directed the SEC ALJs to reevaluate pending proceedings (including those for which an initial decision is pending before the Commission) by reexamining the record, accepting new evidence from the parties, and issuing an order stating whether the ALJ has determined to ratify or revise in any respect the ALJ's prior actions in the matter.

Key Considerations for the Court. If the Supreme Court agrees with the *Lucia* Petitioners and the Solicitor General that SEC ALJs are inferior officers, its decision could have implications for the nearly [2,000 ALJs](#) situated in other agencies across the federal government. Closer examination of the authority, duties, and methods of appointment of those ALJs may demonstrate that their positions are distinguishable from SEC ALJs. Nevertheless, if and how the Court chooses to refine its analysis in *Freytag* undoubtedly will be a key factor in evaluating future Appointments Clause challenges to ALJs.

Whether the Court chooses to address the constitutionality of the limitations on SEC ALJs' removal remains to be seen. Even if the Court declines the Solicitor General's invitation to opine on this question, any decision that SEC ALJs are officers may raise the specter of a future challenge on the removal issue, because, as the Supreme Court noted in *Free Enterprise Fund*, "removal is incident to the power of appointment."

In addition, if the Court concludes that the SEC ALJ's selection violated the Appointments Clause, then the scope of the Court's remedy may set an important precedent for future Appointments Clause challenges. For example, it is unclear whether the Court (or the circuit court on remand) would require the SEC to provide the *Lucia* Petitioners with an entirely new hearing before a constitutionally appointed ALJ or would conclude that the Commission already conducted an independent review of the record on appeal and that a new evidentiary hearing would not change the outcome of the case.

This Court or future courts also may have to grapple with the effects of the SEC's ratification order. In the [Commission's view](#), the order should "put to rest any claim that administrative proceedings pending before, or presided over by, Commission [ALJs] violate the Appointments Clause." However, the *Lucia* Petitioners [argue](#) that an Appointments Clause defect persists because, in their view, the order does not effectuate a valid "appointment" because there was no "prior appointment" to ratify and the order itself does not appoint anyone. Even if the order is held to effectuate valid ALJ appointments for purposes of future proceedings, the SEC still might see challenges to the adequacy of its reevaluation mandate for pending actions and to past decisions that were not subject to reevaluation.

The Supreme Court has not yet scheduled oral argument in *Lucia*, but a decision is expected by the end of June 2018.