

DID THE SEC'S RECENT RATIFICATION OF ALJ APPOINTMENTS END THE CONSTITUTIONAL QUESTION OF AGENCY ALJ APPOINTMENTS?

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Dodd-Frank's Expansion of AP Jurisdiction and Perceived ALJ Bias

The 2010 Dodd-Frank Act expanded administrative jurisdiction to "any person," registered or not, giving the SEC administrative power over any and all accused securities law violators.

In 2014, SEC Enforcement Director Andrew Ceresney announced that the SEC would use its administrative option more often, and the SEC increased the number of its ALJs from three to five.

The SEC changed and began filing about four out of five enforcement actions as administrative proceedings.

This change in forum caused a lot of push back.

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Dodd-Frank and the Perception of ALJ Bias

Following Dodd-Frank, the *Wall Street Journal* did an analysis of the SEC's success rate in court versus before administrative law judges and found that:

- The SEC had a 90% success rate before ALJs;
- The SEC had a 69% success rate in federal court;
- The SEC had a 95% win rate on appeal to the Commission;
- The DOJ had an 84% win rate on appeal in federal appellate courts.

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Dodd-Frank and the Perception of ALJ Bias

Initial challenges to ALJ administrative proceedings focused on equal protection arguments and fundamental fairness.

- In 2011, Judge Jed Rakoff denied the SEC's motion to dismiss a collateral challenge to its administrative forum on equal protection grounds in *Gupta v. SEC*, 796 F. Supp. 2d 503, 511-13 (S.D.N.Y. 2011).
- The parties later settled when the SEC dropped its administrative claims and Gupta dropped his equal protection claims.
- In 2014, two courts denied civil actions attempting to halt SEC administrative proceedings. *Chau v. SEC*, No. 14-cv-1903 (S.D.N.Y. Dec. 11, 2014); *Jarkesy and Patriot28 LLC v. SEC*, Fed. Sec. L. Rep. ¶ 97,990 (D.D.C. June 10, 2014), aff'd 803 F.3d 9 (D.C. Cir. 2015).

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Dodd-Frank and the Perception of ALJ Bias

In November 2014, Judge Rakoff – who was the judge in *Gupta* – criticized the SEC's administrative proceedings at a PLI conference citing its nearly 100 percent win rate before ALJs versus the 61 percent win rate in courts.

In February 2015, SEC Commissioner Michael Piwowar announced at an "SEC Speaks" conference that "[t]o avoid the perception that the commission is taking its tougher cases to its in-house judges, and to ensure that all are treated fairly and equally, the commission should set out and implement guidelines for determining which cases are brought in administrative proceedings and which in federal courts."

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Dodd-Frank and the Perception of ALJ Bias

In May 2015, the *Wall Street Journal* ran an article entitled "SEC Wins with In-House Judges," and quoted a former ALJ who indicated that there was bias in favor of the agency among ALJs. *Wall St. Journal*, May 6, 2015.

In June 2015, the SEC asked ALJs to self report if they were pressured to favor the agency. *In re Timbervest, LLC*, IA Rel. No. 4103, AP File No. 3-15519 (SEC June 4, 2015).

In July 2015, the U.S. Chamber of Commerce recommended changes to SEC enforcement actions.

In January 2016, the SEC's Office of Inspector General said it could not find any ALJ bias.

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The Battle Moves from ALJ Bias to the Constitutionality of ALJs

In August 2015, Judge Berman preliminarily enjoined the SEC's administrative action as "likely unconstitutional" under the Appointments Clause. Duka v. SEC, 124 F. Supp. 3d 287 (S.D.N.Y. Aug. 12, 2015).

The Appointments Clause in the United States Constitution provides: "[T]he Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments." Constitution, Art. II, § 2, cl. 2.

- The Clause requires the President or the SEC Commission to appoint inferior officers.
- The SEC staff, however, selects its ALJs through the civil-service process from a list compiled by its Office of Personnel Management.
- The ALJs have tenure protections, which arguably violate the President's constitutional removal authority.
- The SEC argued that administrative law judges are employees and not "inferior officers" because their decisions are not final due to Commission oversight.

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The Constitutional Questions

- Are SEC ALJs employees or "inferior Officers" for purposes of the Appointments Clause?
- If they are employees, they do not require a presidential appointment.
- If they are "inferior Officers," they are required to be appointed by the President or the Commission.
- If they have tenured job protection, is there a violation of the removal authority of the President or the Commission?

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The Lucia Case: No Constitutional Violation of Appointments Clause

The SEC itself weighed in on the issue in September 2015 in the case of In the Matter of Raymond J. Lucia Cos. Inc., '34 Act Rel. 75837, AP File No. 3-15006 (Sept. 3, 2015), which rejected a constitutional challenge to ALJs based on the Appointments Clause, and held that ALJs are mere employees.

- Commissioners Piwowar and Daniel Gallagher, however, dissented and stated that "[e]ven though the Commission is free to express its views on Constitutional issues, we recognize and believe it is appropriate that Article III federal judges ultimately resolve this issue." (dissent filed on October 2, 2015).

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The Lucia Case: No Constitutional Violation of Appointments Clause

In August 2016, the D.C. Circuit held that ALJs are not constitutional "officers" and thus there is no constitutional violation of the Appointments Clause. Raymond J. Lucia Cos. Inc. v. SEC, 832 F.3d 277 (D.C. Cir. Aug. 9, 2016).

A 10-judge *en banc* panel of the D.C. Circuit deadlocked on the issue, resulting in a one-page *per curiam* order on June 26, 2017, denying Raymond J. Lucia's petition for review. Raymond J. Lucia Cos. Inc. v. SEC, No. 15-1345 (D.C. Cir. June 26, 2017)

- SEC administrative law judges are employees who are not subject to the Appointments Clause of the U.S. Constitution.

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The Lucia Case: No Constitutional Violation of Appointments Clause

- Lucia filed a *cert.* petition on July 26, 2017.
- Lucia noted that in a 2007 memorandum the DOJ's Office of Legal Counsel opined that an "officer of the United States" – the constitutional language at issue – is someone who "possesses delegated sovereign authority to act in the first instance, whether or not that act may be subject to direction or review by superior officers."

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Issues in Lucia v. SEC Circuit Opinion Raised In Petition for Cert.

- Challenge to D.C. Circuit Opinion issued August 9, 2016: Petitioners Arguments.

1. Are ALJs "inferior Officers," which need to be appointed by the President, or the Head of a Department?
2. *Buckley v. Valeo*: an appointee is an inferior Officers and not an employee if the appointee exercises "significant authority pursuant to the laws of the United States;"
3. The main criteria for drawing the line between inferior Officers and employees not covered by the Clause are (i) the significance of the matters resolved by the officials; (ii) the discretion they exercise in reaching their decisions; and (iii) the finality of those decisions.

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Lucia v. SEC Circuit Opinion

- 1. 90% of ALJ decisions are not reviewed by Commission;
- 2. SEC Commission affirms virtually all ALJ decisions; and
- 3. ALJs have significant authority over evidence, testimony, trial and rulings.
- 4. Therefore, ALJs qualify as inferior Officers subject to the appointments clause.

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Lucia v. SEC at the U.S. Supreme Court

- On November 29, 2017, the Solicitor General surprised everyone and said in their Opposition Brief: “the government is now of the view that such ALJs are Officers because they exercise ‘significant authority pursuant to the laws of the United States.’” Buckley v. Valeo.
- The Solicitor General’s Surprise brief:
- “If further review of the ALJ’s decision is not sought or a request for such review is denied by the Commission, the ALJ’s initial decision shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission.”

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Lucia v. SEC Reply Brief on Cert.

- Petitioner’s Reply brief filed on December 13, 2017:
- 1. Government agrees that they are Officers subject to appointments clause;
- 2. The case is not moot because (a) there is no redress for Court of Appeals wrong decision; and (b) petitioner suffered a constitutional deprivation.

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The Bandimere Case: There is a Violation of the Appointments Clause

Bandimere v. SEC, No. 15-9586 (10th Cir. Dec. 27, 2016), reh'g denied, 855 F.3d 1128 (May 3, 2017):

- The Tenth Circuit held that SEC ALJs were “inferior officers” subject to the Appointments Clause.
- The Tenth Circuit denied the SEC’s petition for hearing *en banc* on May 3, 2017.
- The SEC stayed all administrative hearings assigned to an ALJ in which a respondent has the option to seek review in the Tenth Circuit of a final order of the SEC under Section 9(a) of the Securities Act, Section 25(a) of the Securities Act, Section 43(a) of the Investment Company Act, or Section 213 (a) of the Investment Advisers Act. *See In Re: Pending Administrative Proceedings*, SEC Release No. 4708 (May 22, 2017).

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The Bandimere Case: There is a Violation of the Appointments Clause

- The stay was effective immediately and shall remain in effect pending expiration of the time in which the SEC may file a petition for writ of *certiorari* in Bandimere, the resolution of any such petition and any decision issued by the Supreme Court in that case, or further order of the SEC.
- The SEC filed its *cert.* petition on September 29, 2017.

In September 2017, the Fifth Circuit stayed the implementation of a FDIC ALJ’s order, finding that petitioner’s argument that ALJs are unconstitutionally appointed was likely to succeed on the merits. Burgess v. FDIC, No. 17-60579 (Sept. 7, 2017).

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The SEC’s Ratification Action: Is It a Cure?

- On Nov. 29, 2017, the Office of Solicitor General submitted a brief in the Supreme Court in *Raymond J. Lucia and Raymond J. Lucia Companies Inc. v. Securities and Exchange Commission* (No. 17-130) asking the Court to decide whether the Commission’s ALJs are “inferior officers” who must be appointed consistent with the Appointments Clause of the Constitution.
- The Solicitor General’s brief takes the position that the Commission’s ALJs are “inferior officers” subject to the Appointments Clause.
- Ratification Order: In response, the Securities and Exchange Commission on November 30, 2017 announced that it ratified its prior appointment of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil.

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The SEC's Ratification Action: Is It a Cure?

- By ratifying the appointment of its five ALJs, the Commission argues that it has resolved any concerns that administrative proceedings presided over by its ALJs violate the Appointments Clause.
- The Commission Order also directs the ALJs to review their actions in all existing administrative proceedings to determine whether to ratify those actions.

<https://www.sec.gov/litigation/opinions/2017/33-10440.pdf>

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The U.S. Supreme Court grants cert.

- On January 12, 2018, the U.S. Supreme Court granted cert. in *Lucia v. SEC*.
- The Petitioner had argued that the ratification order by the SEC was defective because (i) it could be rescinded tomorrow; (ii) the order only applies to pending cases; and (iii) petitioner is still entitled to a new hearing before a properly appointed Officer.
- The Petitioner argued that the SEC cannot retroactively ratify an earlier unconstitutional appointment.
- The Petitioner told the Court to ignore the removal issue as it was not raised in the Court below.
- ALJs have civil service protections against removal.
- *Timbervest v. SEC*, however, did raise removal issue and was stayed pending the outcome of *Lucia*.

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Practical Impacts of Ratification

Does the ratification order solve appointment issues going forward given protections against removal?

Is there still an appointments issue after ratification order?

What about the past?

What about pending cases?

Is reexamination a cure?

What about closed cases?

Is having 30 days sufficient time to reexamine a case adjudicated by a potentially unconstitutional ALJ?

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Thank You

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