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Constitutionality of SEC's Administrative Law Judges Headed to Supreme Court?

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On December 27, 2016, the Tenth Circuit Court of Appeals found that the appointment of administrative law judges by the Office of Administrative Law Judges of the U.S. Securities & Exchange Commission violated the Appointments Clause of the U.S. Constitution. This holding is in direct conflict with an August 9, 2016 decision by the District of Columbia Court of Appeals. The table is set for a showdown at the U.S. Supreme Court.

Over the past few years the U.S. Securities and Exchange Commission (SEC) has increasingly chosen to file administrative proceedings adjudicated by its very own administrative law judges (ALJs) instead of bringing federal actions. A study by The Wall Street Journal measured the SEC's success rate before ALJs as 90 percent from 2010-2015 compared to 69 percent in federal actions. See Jean Eaglesham, *SEC Wins With In-House Judges*, Wall St. J., May 6, 2015. The results of that study have fueled a discussion about whether it is fair to defendants to have their lives and careers judged by ALJs appointed by the SEC, which also makes all prosecutorial decisions and decides appeals from such ALJ proceedings, as opposed to an independent federal judiciary and juries.

In the midst of this public debate there has been litigation concerning the validity of the SEC ALJ administrative scheme. The first cases filed suit in federal courts sought to halt the ALJ process prior to it running its course. Courts in five Circuit Courts of Appeals held that they could not decide such issues until the ALJ process had concluded.

Then, on August 9, 2016, the District of Columbia Circuit Court of Appeals considered an action in which the ALJ proceeding had concluded with an adverse verdict against the defendant. *See Raymond J. Lucia Cos. Inc. v. SEC*, No. 15-1345 (DC Cir. Aug. 9, 2016), *reh'g en banc petition pending* (DC Cir. Sept. 23, 2016). There the Court considered whether or not the SEC's ALJs were "Officers" and thus subject to the Appointments Clause of the U.S. Constitution. The SEC has conceded that its ALJs are selected by its Office of Administrative Law Judges and not by the President, Courts of Law or the Heads of Departments. Thus, if a court found that the ALJ was an "Officer" then it necessarily would have to find that he or she was appointed in violation of the U.S. Constitution.

The *Lucia* Court found that SEC ALJs were employees who are not subject to the Appointments Clause. It adopted a litmus test – if SEC ALJs issued final decisions of the SEC, then they were subject to the Appointments Clause, and if they did not, they were not subject to that Clause. Although petitioners noted that ALJ rulings are rarely disturbed and the ALJ who presided over the underlying proceeding had not been reversed by the SEC in more than 50 cases, the Court found that the ALJ decisions were not final and thus, the ALJs need not be appointed in conformance with the Appointments Clause.

On December 27, 2016 the Tenth Circuit Court of Appeals reached the opposite conclusion based on a different test. *See Bandimere v. SEC*, No. 15-9586 (10th Cir. Dec. 27, 2016). The Court rejected the litmus test articulated by *Lucia* and instead read applicable precedent to hinge on the ALJs' duties and not on final decision-making power. Under that test, the Tenth Circuit Court of Appeals held that SEC ALJs were inferior officers subject to the Appointments Clause. Accordingly, the Court granted the petition for review and set aside the underlying ALJ decision.

The *Bandimere* Court noted in passing that whether or not SEC ALJs can enter final decisions is not dispositive of its holding but observed that the SEC's argument that ALJs cannot enter such decisions is "not airtight." In particular, the Court noted that 90 percent of all initial SEC ALJ adjudications become final without plenary agency review.

It is important to note that a rehearing en banc has been requested but not adjudicated in *Lucia* and that doubtless the SEC will seek such a rehearing in *Bandimere*. It is likely that other Circuit Courts of Appeals will weigh in on these issues as well. Assuming that the District of Columbia and the Tenth Circuit Courts of Appeals remain in disagreement, the stage is set for the U.S. Supreme Court to decide whether or not SEC ALJs have been operating contrary to the U.S. Constitution. If so, then potentially thousands of past SEC ALJ adjudications may unravel and the future of the SEC's administrative proceeding scheme would remain in question until it complies with the Appointments Clause.

The impact of President-elect Trump and a new SEC Chair on the past and future of SEC ALJ proceedings is unclear. A repeal of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 potentially could include a provision addressing the use of SEC ALJs or provide for an automatic removal right to federal court by defendants facing such proceedings. During this uncertain time, while the issue winds its way to the U.S. Supreme Court for resolution, it is important that defendants in SEC ALJ proceedings preserve all of their rights to object to the administrative proceeding process and any adjudication. In addition, it is important for defendants in past SEC ALJ adjudicated proceedings to consider whether to seek to challenge unfavorable outcomes. If a jurisdictional basis to do so exists, such a challenge should be brought in a U.S. district court in the Tenth Circuit which is compelled to follow *Bandimere*.

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