

## Lucia v. SEC—ALJs Are “Officers” of the United States Who Must Be Appointed under the Appointment Clause

By Robert Cox (August 25, 2018)

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*In a 6–3 ruling, the Supreme Court held that the Securities and Exchange Commission’s (SEC’s) five administrative law judges (ALJs) are “Officers of the United States,” subject to the Appointments Clause of Article II of the U.S. Constitution. Lucia v. SEC, 138 S. Ct. 2044 (2018). The opinion may have wider application beyond the SEC, potentially invalidating the appointments of ALJs at other federal agencies, such as the Social Security Administration or the Federal Energy Regulatory Commission. The Court stated that its holding in Freytag v. Commissioner, 501 U.S. 868 (1991), “says everything necessary to decide this case.” Writing for the majority, Justice Kagan found that SEC ALJs, like the special trial judges in Freytag, hold a continuing office established by law and exercise significant discretion in carrying out important functions, such as taking testimony, conducting trials, and ruling on disputes that could become final if not reviewed by the SEC commissioners. Therefore, ALJs are officers subject to the Appointments Clause who must be constitutionally appointed by the president, courts, or heads of departments, such as the SEC commissioners. Because the ALJ was not constitutionally appointed, he was not authorized to decide the case and Lucia’s case must be retried before a properly appointed ALJ.*

### Background

The SEC initiated an administrative proceeding regarding Raymond Lucia, alleging that he misled investors in violation of the Investment Advisers Act by using misleading slideshow presentations to deceive prospective clients. ALJ Cameron Elliot was assigned to the case. After a nine-day hearing, Judge Elliot issued an initial decision concluding that Lucia had violated the act. On appeal to the commissioners, Lucia argued that the administrative proceeding was invalid because Judge Elliot had not been constitutionally appointed. Judge Elliot had been appointed by SEC staff and thus lacked constitutional authority to do his job. The commission rejected Lucia’s argument, holding that ALJs were “mere employees” and not “Officers of the United States.” Lucia appealed to the D.C. Circuit, which also held that SEC ALJs were employees rather than officers. Lucia petitioned for a rehearing en banc, and the 10 members of the en banc court divided evenly, issuing a per curiam order denying Lucia’s claim.

Lucia petitioned for a writ of certiorari, asking the Supreme Court to resolve the split between the D.C. Circuit decision and the Tenth Circuit decision in Bandimere v. SEC, 844 F.3d 1168, 1179 (10th Cir. 2016), which held that the SEC ALJs were officers. The government had previously defended the commission’s position that SEC ALJs were not officers, but in its response to Lucia’s position, the government switched sides and argued that the ALJs were officers. Soon after the government filed its response changing its position, the commission issued an order ratifying the appointments of the ALJs.

## Decision

The sole question before the Supreme Court was whether the SEC's ALJs are "officers of the United States" or simply employees of the government. The Appointments Clause prescribes the exclusive means of appointing "Officers." Only the president, a court, or a head of department can appoint an officer. See *U.S. Const., art. II, § 2, cl. 2*. The Court then considered whether the ALJs were non-officer employees, "part of the broad swath of 'lesser functionaries' in the Government's workforce." In *Buckley v. Valeo*, 424 U.S. 1 (1976), the Court determined that members of a federal commission were officers only after finding that they "exercise[ed] significant authority pursuant to the laws of the United States." In *Lucia*, the government and the amicus curiae appointed to defend the judgment below urged the Court to elaborate on *Buckley's* "significant authority" test, but the Court found that its decision in *Freytag* made this unnecessary.

In *Freytag*, the Court considered whether "special trial judges" (STJs) of the U.S. Tax Court were officers. In narrow and minor matters, STJs could both hear and definitively resolve a case for the Tax Court. In more major matters, STJs could preside over the hearing but could not issue the final decision. The STJ would prepare proposed findings and an opinion for a regular Tax Court judge to consider. Citing *United States v. Germaine*, 99 U.S. 508, 510 (1879), the Court in *Freytag* held that STJs held a continuing office established by law. Then the Court considered the significance of authority test from *Buckley*. The Court found that STJs take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders, stating that "[i]n the course of carrying out these important functions, the [STJs] exercise significant discretion."

In *Lucia*, the Court applied its reasoning in *Freytag* to find that the commission's ALJs, like the Tax Court's ALJs, hold a continuing office established by law. Commission ALJs receive a career appointment from commission staff.

The Court then applied the "significant authority" test, finding that commission ALJs exercise the same significant discretion when carrying out the same important functions as STJs do. The Court found that there were four specific overlapping powers that *Freytag* mentioned that were also shared by SEC ALJs:

1. Both ALJs and STJs take testimony in which they receive evidence and examine witnesses at hearings, and may also take prehearing depositions.
2. Both ALJs and STJs conduct trials in which they administer oaths, rule on motions, and generally regulate the course of a hearing.
3. Both ALJs and STJs rule on the admissibility of evidence and thus critically shape the administrative record.
4. Both ALJs and STJs have the power to enforce contemptuous conduct, including violations of orders.

The Court found that "point for point—straight from *Freytag's* list—the Commission's ALJs have equivalent duties and powers as STJs in conducting adversarial inquiries."

Further, at the close of proceedings, SEC ALJs issue decisions as in *Freytag*. However, the SEC ALJs can have potentially more independent effect than STJs because the SEC can decide against reviewing an ALJ decision, unlike the Tax Court judge who must always review an STJ's opinion. When the SEC declines review, the ALJ's decision itself becomes final and is "deemed the action of the Commission." *17 C.F.R. § 201.360(d)(2)*. The Court held "[t]hat last-word capacity makes this an *a fortiori* case: If the Tax Court's STJs are officers, as *Freytag* held, then the Commission's ALJs must be too."

The Court concluded that because *Lucia* had timely challenged "the constitutional validity of the appointment of an officer who adjudicates his case" (quoting *Ryder v. United States*, 515 U.S. 177, 182–83 (1995)), he is entitled to relief. Based on *Ryder*, the Court held that the "'appropriate' remedy for an adjudication tainted with an appointments violation is a new 'hearing before a properly appointed' official." The Court added a further requirement that the official who heard *Lucia's* case, Judge Elliot, could not hold the new hearing on *Lucia's* case, even if he has not received, or receives sometime in the future, a constitutional appointment. The Court stated that "[t]o cure the constitutional error, another ALJ (or the Commission itself) must hold the new hearing to which *Lucia* is entitled."

The Court did not directly address whether the commission's subsequent appointment of the previously hired ALJs could cure the defective appointments. Footnote 6 of the opinion suggests that the rehearing of a case should be remanded to a constitutionally appointed ALJ: "The Commission has not suggested that it intends to assign Lucia's case on remand to an ALJ whose claim to authority rests on the ratification order." This means that a rehearing before one of the ALJs whose appointment the commission "ratified" would be insufficient.

### Implications

After *Lucia*, a respondent before the SEC who has raised a constitutional challenge to an SEC ALJ to request a new hearing. Hundreds of litigants before SEC ALJs have raised constitutional challenges to the SEC ALJ who held a hearing in their matters. This may mean that hundreds of new hearings will need to be conducted before properly appointed SEC ALJs. However, if a litigant has not previously raised a constitutional challenge to the ALJ, the Court seemingly closes that litigant's ability now to challenge the ALJ's ruling.

The Court did not offer any guidance as to the status of ALJs in other agencies. While it is unclear what implications *Lucia* will have on ALJs at other agencies, the decision will certainly result in numerous challenges by litigants to ALJs at such agencies as the Social Security Administration, the Federal Energy Regulatory Commission, the Department of Labor, the National Labor Relations Board, and the Department of Health and Human Services. Given the fact-specific inquiry under the "significant authority" test, the government may still have the ability to distinguish the facts of *Lucia* from the authority held by ALJs in other agencies.

In addition, ALJs will now be political appointees, which means that the philosophical bent of ALJs will change with a successor administration of a different political party from the prior administration. In addition, the

Senate may argue that ALJ appointments be subject to advice and consent, which is required for all officers, unless there is a statutory exception.

In response to *Lucia*, on July 10, 2018, President Trump issued an executive order designating ALJs as "excepted service" and directing the U.S. Office of Personnel Management (OPM) to pursue any necessary revisions to its regulations swiftly. By the terms of the order, agencies may begin making Schedule E appointments to the position of ALJ immediately, without prior OPM approval. The order also eliminates the need for OPM to conduct additional ALJ competitive examinations. A July 10, 2018, OPM memorandum regarding the executive order addresses the status of current ALJs as follows:

An ALJ appointed prior to the effective date of the EO is an employee in the competitive service. Such an employee is subject to the requirements of the competitive service. An ALJ serving in the competitive service who accepts a new appointment after July 10, 2018, moves from the competitive service to the excepted service.

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