D.C. Circuit Upholds Constitutionality of SEC Administrative Law Judges

The Securities and Exchange Commission ("SEC") scored a significant victory yesterday in its quest to defend the increased use of its in-house judges when a three-judge panel of the D.C. Circuit ruled that the appointment of the SEC's administrative law judges ("ALJs") does not flout constitutional requirements.[i] Notably, this is the first time a circuit court of appeals has ruled on the merits of the constitutionality issue.

The appeal involved a review of an SEC opinion upholding an ALJ's initial decision finding Raymond J. Lucia and his entities liable for misleading statements under the Investment Advisers Act of 1940. As part of its opinion, the SEC rejected Lucia's arguments that the administrative hearing was unconstitutional because the ALJ presiding over the matter was unconstitutionally appointed. The key question at issue was whether the ALJ was simply an employee of the SEC, or rather whether he should be considered an "inferior officer" of the United States, subjecting his appointment to the requirements of the Appointments Clause of Article II of the Constitution.[ii] Not surprisingly, the SEC found that its ALJ was an employee, not an inferior officer, and therefore not subject to the Appointments Clause.[iii]

On appeal to the D.C. Circuit, the Appointments Clause issue was squarely teed up for the circuit panel. In its briefs, the SEC staff conceded that the ALJ was not appointed in compliance with the Appointments Clause and that the SEC's opinion could not stand if the circuit court found the ALJ's appointment to be unconstitutional.

In answering the central question of whether SEC ALJs are inferior officers or employees, the three-judge panel focused on an ALJ's authority to issue final decisions of the SEC.[iv] Significantly, the parties were in dispute on this central issue, with petitioners arguing that the ALJs had the ability to issue final decisions under certain circumstances and the SEC staff arguing that only the Commission itself could render final decisions.

In siding with the SEC, the three-judge panel found it significant that under SEC rules an ALJ's initial decision could only become final upon order of the Commission. Additionally, the panel noted that prior to issuing its finality order, the Commission retains the power in every case to conduct a review of an ALJ's initial decision regardless of whether an appeal is filed. The panel also found convincing the fact that the Commission reviews an ALJ's initial decision de novo and "may affirm, reverse, modify [or] set aside" the initial decision "in whole or in part . . . ." Based on these factors, the panel held that the SEC ALJs were employees and not inferior officers, and thus their appointment was not subject to the requirements of the Appointments Clause.

No doubt this decision will bolster the SEC's continued use of its administrative forum even in the face of criticism that the forum gives the agency an unfair advantage when compared to litigation in federal district courts. Parties suspected of securities law violations will have to remain prepared to defend themselves in administrative proceedings. However, the SEC is not yet completely out of the woods. SEC enforcement cases are pending on appeal in other circuits where the Appointments Clause issue

410 17th Street, Suite 2200
Denver, Colorado 80202

may be considered and respondents are likely to continue raising constitutional arguments in administrative proceedings outside of the D.C. Circuit.[v] If a circuit split develops, this issue ultimately may have to be decided by the Supreme Court.

John V. McDermott
Shareholder
jmcdermott@bhfs.com
303.223.1118

Jeffrey S. Rugg
Shareholder
jrugg@bhfs.com
702.464.7011

Van Aaron Hughes
Of Counsel
vhughes@bhfs.com
303.223.1253

Carrie E. Johnson
Associate
cjohnson@bhfs.com
303.223.1198

David B. Meschke
Associate
dmeschke@bhfs.com
303.223.1219

Maximilien D. Fetaz
Associate
mfetaz@bhfs.com
702.464.7083

Thomas J. Krysa
Shareholder
tkrysa@bhfs.com
303.223.1270

Lawrence W. Treece
Shareholder
ltreece@bhfs.com
303.223.1257

Emily R. Garnett
Associate
egarnett@bhfs.com
303.223.1171

Joshua A. Weiss
Associate
jweiss@bhfs.com
303-223-1268

Elizabeth G. Tillotson
Associate
etillotson@bhfs.com
303.223.1173

[i] *Raymond J. Lucia Companies, Inc. and Raymond J. Lucia v. SEC*, No. 15-1345 (D.C. Cir., Aug. 9, 2016).
[ii] 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, whose Appointments are not herein otherwise provided for, and which shall be established by Law; but the 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.
> U.S. Const. art. II, § 2, cl. 2.

[iii] *Raymond J. Lucia Companies*, Exchange Act Release No. 75837, 2015 WL 5172953, at *21-23 (Sept. 3, 2015). The SEC ruled similarly in three subsequent matters on appeal. *See* David F. Bandimere, Exchange Act Release No. 76308, 2015 WL 6575665, at *19 (Oct. 29, 2015), *petition for review filed*, No. 15-9586 (10th Cir. Dec. 22, 2015); Timbervest, LLC, Advisers Act Release No. 4197, 2015 WL 5472520, at *23-26 (Sept. 17, 2015), *petition for review filed*, No. 15-1416 (D.C. Cir. Nov. 13, 2105); *John J. Aesoph, CPA and Darren M. Bennett, CPA*, Exchange Act Release No. 78490, August 5, 2016.
[iv] Final decision-making authority was also central to two prior decisions cited by the panel. *Compare Freytag v. Comm'r, Internal Revenue*, 501 U.S. 868 (1991) *with Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000).
[v] *See e.g., David F. Bandimere*, Exchange Act Release No. 76308, 2015 WL 6575665, at *19 (Oct. 29, 2015), *petition for review filed*, No. 15-9586 (10th Cir. Dec. 22, 2015); *Gray Financial Group Inc. v. SEC*, No. 15-cv-00492, ECF No. 56 (N.D. Ga. Aug. 4, 2015) (appeal pending); *Duka v. SEC*, No. 15 Civ. 357 (RMB)(SN), 2015 WL 4940057 (S.D.N.Y. Aug. 3, 2015) (appeal pending); *Hill v. SEC*, No. 1:15-CV-1801-LMM, 2015 WL 4307088 (N.D. Ga. June 8, 2015) (appeal pending).

410 17th Street, Suite 2200
Denver, Colorado 80202