SEC REVERSES COURSE ON ALJ APPOINTMENTS ISSUE, BUT UNCERTAINTY REMAINS

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On Thursday, November 30, 2017, the Securities and Exchange Commission ("SEC" or the "Commission") took action to settle an issue that had been impacting its enforcement efforts for some time: whether its administrative law judges ("ALJs") who preside over administrative proceedings brought by its Division of Enforcement must be appointed in accordance with the Constitution's Appointments Clause and therefore currently lack the authority to hear cases. The SEC had faced a large number of legal challenges in recent years raising the issue as the Commission increasingly utilized its in-house judges to adjudicate contested matters. [1]

In a surprising move, the Commission ratified the appointments of the SEC's five ALJs to put to rest any concern that their decisions and operations violated the Appointments Clause, which requires "inferior officers" to be appointed by the president, a court of law, or the head of a department, such as the SEC. [2] The decision was announced one day after the SEC reversed its position in a pending case and argued that its ALJs are "inferior officers" whose appointments must comply with the Appointments Clause, not "mere employees" who can be hired through the civil service system.

For parties subject to administrative actions, the Commission's decision to ratify its ALJs' appointments eliminates one potential line of attack. However, by acknowledging that its ALJs are officers of the United States, the Commission may have fostered a new constitutional challenge. While administrative respondents may no longer challenge the constitutionality of their hearing officers' appointments, respondents may now consider challenging whether the removal provisions applicable to ALJs comport with the Constitution.

APPOINTMENTS CLAUSE CHALLENGES: A LINGERING ISSUE

In December 2016, the U.S. Court of Appeals for the Tenth Circuit held that the SEC's ALJs had not been appointed constitutionally because they are "inferior officers" who "exercise significant authority" pursuant to the laws of the United States but who are not appointed by the president, a court of law, or a head of department. [3] That decision forced the Commission to bring all of its litigated enforcement actions for which review could be sought in the Tenth Circuit in federal court, rather than through administrative proceedings before its ALJs.

The Tenth Circuit's decision conflicted with an earlier decision by the U.S. Court of Appeals for the District of Columbia Circuit, which held that SEC ALJs are not inferior officers subject to the Appointments Clause because they lack final decision-making authority. [4] Over the past year, the SEC has consistently argued that the D.C. Circuit came to the correct conclusion and the Tenth Circuit's reasoning was flawed. In May, for example, the SEC forcefully argued before the D.C. Circuit, sitting en banc, that its ALJs are employees, not inferior officers, and thus are not subject to the protections of the Appointments Clause.

Accordingly, the SEC's abrupt about-face surprised many in the industry. The day before the Commission ratified the appointments of its ALJs, the Office of the Solicitor General filed a brief in response to a petition for certiorari arguing that SEC ALJs are inferior officers subject to the Appointments Clause, reversing the government's position that SEC ALJs are employees of the Commission. In its brief, the government said it would no longer defend the D.C. Circuit's decision upholding the Commission's use of ALJs and recommended the Supreme Court appoint amicus curiae to defend the D.C. Circuit's judgment.

While the SEC and the petitioners for certiorari now agree that SEC ALJs are inferior officers subject to the Appointments Clause, the SEC urged the Supreme Court to grant certiorari nonetheless. Seemingly, no case or controversy remains between the parties. However, the Solicitor General argued the issue is not moot because a Supreme Court ruling would affect dozens of other federal agencies who also utilize ALJs. The Supreme Court may accept that argument, although it may consider the issue moot and await another opportunity to analyze the constitutionality of ALJs.

ALJ REMOVAL SCHEME: THE NEXT CONSTITUTIONAL CHALLENGE?

While the SEC settled the Appointments Clause issue by ratifying the appointments of its ALJs, it may have created a larger problem in doing so. By acknowledging that SEC ALJs are officers of the United States, the SEC may have opened itself up to challenges that certain other Constitutional requirements apply to its ALJs as well, such as the separation of powers requirement that prohibits Congress from placing restrictions on the president's power to remove officers of the United States from their positions.

Because “Article II confers on the President the general administrative control of those executing the laws,” the president must have the power to remove officers who carry out executive functions. [5] Accordingly, Congress is forbidden from creating statutory schemes that grant inferior officers two layers of protection from presidential removal authority because such schemes allow an agency to exercise executive authority without meaningful presidential oversight. [6]

Here, SEC ALJs currently enjoy two layers of tenure protection. SEC ALJs may only be removed by the Commission for good cause established by the Merit Systems Protection Board, the members of which may only be removed by the president for good cause. [7] The Supreme Court invalidated a similar scheme in Free Enterprise Fund, in which the members of the Public Company Accounting Oversight Board could only be removed for good cause established by the SEC, whose members themselves could only be removed by the president for good cause. [8]

While parties subject to SEC administrative actions may no longer allege that their adjudicator was appointed in violation of the Appointments Clause, the SEC's acknowledgement that its ALJs are officers of the Unites States may give such parties an opening to allege that SEC ALJs are unconstitutionally insulated from presidential removal. It remains to be seen whether the Supreme Court will take the opportunity to provide clarity on the Appointments Clause issue and grant certiorari, and if so whether it will add the removal issue to the question presented, as the Solicitor General urged it to do. In the meantime, parties seeking to challenge an SEC ALJ's authority to adjudicate a contested matter may consider asserting that the ALJ's decisions are infirm because the ALJ remains unconstitutionally protected from removal.

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[1] For additional background information, see our previous alerts on this subject: Tenth Circuit Decision Finds Against SEC and Creates a Circuit Split on the Constitutionality of the Commission's ALJs and D.C. Circuit Considers Reversal of Earlier Decision and May Declare SEC Administrative Law Judges Inferior Officers Subject to Appointment.

[2] In re Pending Administrative Proceedings, Securities Act Release No. 10440 (Nov. 30, 2017); U.S. Const. art. II, § 2, cl. 2. In its order, the Commission directed all of its ALJs who are currently presiding over pending administrative actions for which no initial decision has yet been reached to reconsider the record, allow the parties to submit any new evidence, and determine whether to ratify or revise all prior actions taken by the ALJ in the proceeding. In addition, the Commission remanded all matters pending before the Commission in which one of its ALJs has issued an initial decision and directed each ALJ to reconsider the record in the matter, allow the parties to submit any new evidence, and determine whether to ratify or revise all of the ALJ's prior actions.

[3] Bandimere v. SEC, 844 F.3d 1168, 1179-82 (10th Cir. 2016), reh'g denied, 855 F.3d 1128 (10th Cir. 2017), petition for cert. pending, No. 17-475 (filed Sept. 29, 2017).

[4] Raymond J. Lucia Cos. v. SEC, 832 F.3d 277, 285-87 (D.C. Cir. 2016), petition for review denied, 868 F.3d 1021 (D.C. Cir. 2017), petition for cert. pending, No. 17-130 (filed July 21, 2017).

[5] Free Enterprise Fund v. PCAOB, 561 U.S. 477, 492-93 (2010) (internal quotation marks and citation omitted).

[6] Id. at 497.

[7] 5 U.S.C. § 7521(a); 5 U.S.C. § 1202(d).

[8] 561 U.S. at 487 (citation omitted).

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