Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Lucia Leaves Many Important Questions Unanswered

By **Michael Birnbaum, Jordan Eth, Joel Haims and Craig Martin** (June 25, 2018, 5:30 PM EDT)


Michael Birnbaum


Jordan Eth


Joel Haims


Craig Martin

In Lucia v. U.S. Securities and Exchange Commission, Justice Elena Kagan, writing for a six-justice majority, presents the U.S. Supreme Court's decision as both narrow and uncomplicated. "The sole question" the court chose to decide was whether the SEC's administrative law judges, or ALJs, "are 'Officers of the United States' or simply employees of the Federal Government."[1] If officers, the Constitution's appointments clause requires that the president, a court of law, or a head of a department appoint the ALJs, and the commission conceded that its ALJs were not so appointed.

The court found the question of whether the commission's ALJs qualified as "officers" to be conclusively resolved by its prior decisions, including Freytag v. Commissioner, a case in which the court held that the Tax Court's special trial judges, or STJs, were officers. Freytag, the court explained, "necessarily decides" Lucia,[2] as the SEC's ALJs exercise powers nearly indistinguishable from those employed by the Tax Court's STJs: Both "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders," and in so doing, "exercise significant discretion."[3] Because the ALJs (like the STJs) exercise "significant authority," the court reasoned, they are officers, and the commission's failure to appoint ALJs consistent with the appointments clause meant ALJ Cameron Elliot's exercise of that authority in the Lucia matter was unconstitutional.

But while the Lucia court's reasoning might be straightforward, predicting the decision's impact is far from simple. Many federal agencies must now revisit whether their judges might be deemed officers under Lucia, and the SEC itself must figure out what to do with a backlog of matters previously adjudicated by its own ALJs, and how to appoint judges without inviting further constitutional challenges.

Lucia Provides Little Guidance to Other Agencies

As the Lucia court acknowledged, the "significant authority" standard the court derived from Buckley v. Valeo[4] as offering a test for what constitutes an officer is framed only "in general terms, tempting advocates to add whatever glosses best suit their arguments."[5] In his concurring opinion, Justice Clarence Thomas (joined by Justice Neil Gorsuch) lamented the lack of guidance the court's precedents offer in

determining precisely what constitutes "significant authority" and argued that all federal civil officials with a "responsibility for an ongoing statutory duty" should be deemed "officers."[6] But the majority not only rejected Justice Thomas's test, it declined to offer one of its own, stating: "[M]aybe one day we will see a need to refine or enhance the test Buckley set out so concisely," "[b]ut that day is not this one."[7]

As Justice Sonia Sotomayor argued in a dissent joined by Justice Ruth Bader Ginsburg, the court's "lack of guidance is not without consequence," as the confusion it creates as to which other agencies' judges should be deemed officers "can undermine the reliability and finality of proceedings and result in wasted resources."[8] Indeed, other federal agencies whose judges exercise some, but not all, of the authority employed by SEC ALJs are left to guess whether their judges must be appointed consistent with the appointments clause. Given the high price of an agency guessing wrong, federal agencies employing administrative judges with powers remotely approaching "significant authority" will need to consider prophylactic measures to protect the decision-making authority of their judges, and reconsider the extent to which they should rely on administrative proceedings until Congress or the courts provide additional guidance.

Lucia Leaves the SEC with Many Unresolved Questions

For the SEC, Lucia is, in some ways, the worst of all worlds, because the court not only held that existing ALJs were not properly appointed, it also called into question the means by which the SEC might fix that problem.

First, the SEC must determine how to proceed with the many cases already instituted before its ALJs. On Nov. 30, 2017, the commission issued an order under the caption "In re: Pending Administrative Proceedings" stating, in relevant part, as follows: "To put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause, the Commission — in its capacity as head of a department — hereby ratifies the agency's prior appointment of [its ALJs]."[9]

In that same order, the commission listed more than 100 matters then pending before the commission in which an ALJ had issued an initial decision, and instructed the ALJs who had issued such decisions to review them (and other actions taken in those proceedings) and issue orders ratifying or revising their earlier decisions based on a reconsideration of the record. But the Lucia court would not appear to put much stock in these "reconsidered" initial decisions. To cure the constitutional error of permitting ALJ Elliot to hear Raymond Lucia's case, the court held that any new hearing must be conducted by a different ALJ (or by the SEC itself), as Judge Elliot "cannot be expected to consider the matter as though he had not adjudicated it before."[10] Because Lucia was already before the Supreme Court when the SEC issued its Nov. 30, 2017, order, Judge Elliot was never asked to ratify or revise his decision, but the commission would proceed at considerable peril relying on that distinction to remand other matters back to the ALJs who previously issued similar initial decisions.

Then there is the category of matters commenced before ALJs but for which no initial decision has yet been issued. The commission might argue that the ALJs had not "adjudicated" those matters in the way Judge Elliot did when he issued an opinion setting forth his opinion as to liability and remedies, but respondents in those cases will surely argue in many matters that the ALJs had already done too much to be expected to approach their particular cases with fresh eyes. The commission, mindful of the challenges these matters will present, issued an order within hours of the Supreme Court issuing its Lucia decision, staying all pending administrative proceedings for 30 days.[11] Perhaps offering some

insight into how the commission might proceed in these pending — and, perhaps, many remanded — actions, the June 21 order stated that it "does not preclude the Commission from assigning any proceeding currently pending before an administrative law judge to the Commission itself or to any member of the Commission at any time."[12] The commission deciding such matters directly — i.e., cutting the ALJs out of the process entirely — may be attractive as a means of avoiding appointments clause problems, but the sheer volume of pending matters would seem to make that approach impracticable if a significant number of respondents sought a new hearing.

Finally, there exists a category of litigants whose appeals of "initial decisions" are currently pending, but who might have failed to preserve any appointments clause challenges to the authority of the ALJs hearing their respective cases. Indeed, the Supreme Court granted certiorari in one case — Lorenzo v. SEC, an appeal regarding the scope of actionable "fraudulent scheme claims" — just days before announcing its Lucia decision, by which time the court surely knew how it would rule in Lucia. Perhaps it was with those litigants in mind that the court explained that petitioner Lucia, as "'one who ma[de] a timely challenge to the constitutional validity of the appointment of an officer who adjudicate[d] his case,' is entitled to relief."[13] Should the commission decline to exercise its discretion and withdraw its claims in these cases, many individuals and entities will face potential sanctions — ranging from monetary penalties to bars from working in the securities industry — initially imposed by judges who the Supreme Court has now announced had no authority to decide the matters before them. Complicating matters further, should appellate courts remand such cases based on some merits-based reversal, the commission will need to find an appropriate way to adjudicate those cases going forward.

The Commission Has No Easy Fix — Even for New Cases

The commission's Nov. 30, 2017, order ratifying the appointment of ALJs might place those judges on firmer footing for newly filed cases, but even that is far from clear. The Lucia court expressly declined to address the validity of the commission's Nov. 30 order,[14] and further noted that the commission's direct appointment of ALJs would not resolve all constitutional challenges to ALJs' authority in expressly declining to address whether certain statutory restrictions limiting the removal of ALJs violate the Constitution's executive vesting clause.[15] This constitutional challenge, which the solicitor general urged the court to address, is based on the court's holding in Free Enterprise Fund v. Public Company Accounting Oversight Board[16] that the executive vesting clause forbade Congress from providing PCAOB members, as "inferior officers," with "multilevel protection from removal."[17] As Justice Stephen Breyer notes in his partial dissent in Lucia, the complicated question of whether the ALJs would likewise impermissibly have "multilevel protection from removal" is "potentially dramatic."[18] "*If* the Free Enterprise Fund Court's holding applies equally to the administrative law judges — and I stress the 'if' — then to hold that the administrative law judges are 'Officers of the United States' is, perhaps, to hold that their removal protections are unconstitutional."[19] By declining to address this removal question, the Lucia court left the commission (and any similarly situated agencies) in limbo, knowing even an effort to address the appointments clause problem decided by the court might run afoul of the Constitution's executive vesting clause.

Conclusion

The Supreme Court's decision in Lucia leaves unanswered more questions than it resolves. Litigants cannot be sure how the SEC will handle pending matters (or whether the SEC's approach will be deemed constitutional), and the SEC cannot be sure how ALJs should be appointed in the future to avoid additional judicial scrutiny. Other agencies hoping the court would offer a bright-line rule to clarify when administrative judges are deemed officers for appointments clause purposes are left, as the court

acknowledged, with little guidance. In short, we can expect court dockets to be full with cases interpreting Lucia for years to come.

Michael D. Birnbaum is a partner at Morrison & Foerster LLP. Before joining the firm in May, Birnbaum was a senior SEC trial counsel and spent 11 years at the agency overseeing securities litigation before federal and administrative courts.

Jordan Eth and Joel C. Haims are partners at Morrison & Foerster and co-chairmen of the firm's securities litigation, enforcement and white collar criminal defense group.

Craig D. Martin is firmwide managing partner at Morrison & Foerster.

Disclosure: Michael Birnbaum worked on matters for the SEC currently pending before the commission and its administrative law judges.

[1] Lucia v. SEC, 585 U. S. ____ (2018), slip. op. at 5.

[2] Id. at 6, citing Freytag v. Commissioner, 501 U. S. 868 (1991); id. at 8 ("Freytag says everything necessary to decide this case").

[3] Id. at 7, citing Freytag at 882.

[4] Buckley v. Valeo, 124 U.S. 1 (1976) (per curiam).

[5] Lucia at 6.

[6] Lucia, Thomas, J., concurring, at 1.

[7] Lucia at 7.

[8] Lucia, Sotomayor, J., concurring, at 1.

[9] Securities Act Release No. 10440, at 1 (Nov. 30, 2017).

[10] Lucia at 12-13.

[11] Securities Act Release No. 10510 (June 21, 2018).

[12] Id.

[13] Lucia at 12, quoting Ryder v. United States, 515 U. S. 177, 182–183 (1995).

[14] Id. at 13 n.6.

[15] Lucia at 4 n.1.; id., Breyer, J., concurring in judgment and dissenting in part, at 3-4 (describing removal issue).

[16] 561 U.S. 477 (2010).

[17] See Lucia, Breyer, J., concurring in judgment and dissenting in part, at 4.

[18] Id. at 5.

[19] Id. at 6 (emphasis in original).