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ALJ Appointments Issue Now Primed For Supreme Court Review

By **Justin Shur and Eric Nitz**

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"[I]t is ordered and adjudged that the petition for review is denied by an equally divided court." With that single sentence, the en banc D.C. Circuit in Raymond J. Lucia Cos. v. U.S. Securities and Exchange Commission all but guaranteed that the U.S. Supreme Court will weigh in on a question that has divided circuits and district courts alike: whether administrative law judges (ALJs), who hear most SEC enforcement actions in the first instance, are currently appointed in a manner that complies with the Constitution's appointments clause. The question isn't merely academic. The resolution of that question has the potential to invalidate thousands of SEC enforcement actions and redraw the contours of the administrative state.

The Problem: The Constitutional Requirements for Appointing "Officers"

The appointments clause requires that all "officers of the United States" be appointed by the president with the advice and consent of the Senate. It also authorizes an exception for so-called "inferior officers." Congress may "by law" vest the appointment of such officers in the "president alone," in the "courts of law," or in the "heads of departments." ALJs are not appointed using either process.

Thus, the critical question is whether ALJs fall within the meaning of "officers" as used in the appointments clause. If they are mere "employees" and not "officers of the United States," the constitutional requirements of the appointments clause do not apply. If ALJs are officers, their appointment does not conform to the clause's requirements. Lacking a constitutionally proper appointment, they lack authority to preside over the proceedings brought before them.

D.C. Circuit: ALJs are Not "Officers"

Given the high volume of administrative cases the D.C. Circuit hears each year, it is perhaps unsurprising that the D.C. Circuit was one of the first courts in the country to consider whether ALJs are appointed in a manner that violates the appointments clause. The D.C. Circuit first considered this question in Landry v. Federal Deposit Insurance Corp.,[1] holding that FDIC ALJs are not officers.

The D.C. Circuit applied the Supreme Court's decision in Freytag v. Commissioner,[2] which held that special trial judges on the Tax Court were officers for purposes of the appointments clause because they exercised significant sovereign authority. Special trial judges possessed "the authority to render the final decision of the Tax Court" in certain proceedings and, in all proceedings, the special trial judges' findings of fact and credibility determinations received deference from the Tax Court. By contrast, Landry

explained, the FDIC's ALJs possess no such authority: The ALJs issued only "a 'recommended decision, recommended findings of fact, recommended conclusions of law, and [a] proposed order.'" The FDIC itself issued the final decisions of the agency and made its own findings of fact. Because the ALJs were not the final word of the agency, the D.C. Circuit held they were not officers under the appointments clause.

Judge A. Raymond Randolph concurred in the judgment in Landry but disagreed with the court's appointments clause analysis. He would have held that ALJs are inferior officers. Freytag, Judge Randolph explained, did not make final decision-making authority the touchstone of officership that the Landry majority's analysis did. Instead, Judge Randolph viewed Freytag's reference to the special trial judges' authority to issue the final decisions of the Tax Court as an alternative rationale to support its holding. Aside from the ability to exercise final decision-making authority, Judge Randolph found "no relevant differences between the ALJ in [Landry] and the special trial judge in Freytag." Both "'take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders,'" and in doing so, both "'exercise significant discretion.'"

The SEC's ALJs Come Under Fire

For over a decade, Landry remained the definitive case on the status of ALJs under the appointments clause. Recently, however, targets of SEC enforcement actions began challenging the appointment of the SEC's ALJs. Largely rejecting Landry's reasoning (and adopting the reasoning of Judge Randolph's concurrence), district courts began holding that SEC ALJs were officers within the meaning of the appointments clause.

In Hill v. SEC, for example, the Northern District of Georgia held that SEC ALJs were officers.[3] The court concluded that, like the special trial judges in Freytag, the SEC's ALJs exercise significant sovereign authority. It rejected Landry's reasoning, agreeing with Judge Randolph's reading of Freytag — that, even setting aside the special trial judges' authority to enter final decisions of the Tax Court, the special trial judges' remaining powers were "independently sufficient" to give them the status of officers under the appointments clause. Because those powers were "nearly identical" to those exercised by SEC ALJs, the court held that Freytag required the conclusion that SEC ALJs were officers. Shortly after Hill, the Southern District of New York reached the same conclusion in Duka v. SEC.[4]

The Divide Deepens: The D.C. Circuit Reaffirms Landry While the Tenth Circuit Creates a Circuit Split

In Raymond J. Lucia Cos. v. SEC, the D.C. Circuit became the first court of appeals to take up the question decided in Hill and Duka — whether SEC ALJs are "officers" within the meaning of the appointments clause.[5] The court noted that Landry did not resolve the constitutional status of ALJs for all agencies," just FDIC ALJs.[6] But the court refused to consider whether Landry was in tension with Freytag. In that regard, the court adhered to Landry as the law of the circuit.

Applying Landry, the D.C. Circuit concluded that SEC ALJs — like the FDIC ALJs in Landry — did not issue the final decisions of the SEC. It did so despite the statutory mandate that the decision of an ALJ, when not reviewed by the SEC, "shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." The court recognized that language, but did not find it determinative: "[U]pon deciding not to order review" of the ALJ's decision, the D.C. Circuit observed, "the Commission issues an order stating that it has decided not to review the initial decision." Thus, in all cases, the SEC takes an affirmative act with respect to the ALJ's decision — it either issues an order declining to review the decision, or it exercises its right of de novo review over the ALJ's decision. As the D.C. Circuit

remarked, “the passage of time is not enough to establish finality.” As a result, the “initial decisions [of SEC ALJs] are no more final than the recommended decisions issued by FDIC ALJs.” The court thus concluded that Landry controlled and the SEC ALJs lacked the sort of sovereign authority that renders one an officer under the appointments clause.

Last December, the Tenth Circuit broke starkly with that view. In Bandimere v. SEC, the Tenth Circuit created a circuit split, holding that SEC ALJs were officers within the meaning of the appointments clause.[7] Applying Freytag, the Tenth Circuit concluded that officers possess three basic characteristics: (1) their positions are “established by law”; (2) their “duties, salaries, and means of appointment” are specified by statute; and (3) they “exercise significant discretion” in “carrying out ... important functions.” SEC ALJs, the Tenth Circuit reasoned, satisfy each of those characteristics. Their position — including duties, salary, and means of appointment — were established by law. And they exercised significant discretion in fulfilling their duties, enjoying powers and responsibilities that were nearly identical to those of the special trial judges in Freytag.

In reaching that conclusion, the Tenth Circuit explicitly considered and rejected the D.C. Circuit’s rationales in Raymond J. Lucia and Landry. Those cases, the Tenth Circuit said, “place undue weight on final decision-making authority” as the touchstone of officership. Invoking Judge Randolph’s Landry concurrence, the Tenth Circuit noted that Freytag’s discussion of final decision-making authority was simply an alternative rationale to support the decision it had already reached. And it explained that, in Edmond v. United States, the Supreme Court had held that a military judge on an intermediate appellate court is an “inferior officer” even though his decisions were subject to further review. That judge lacked final decision-making authority, yet the court still labeled him an officer within the meaning of the appointments clause.

Judge Monroe McKay dissented from Bandimere’s holding. He emphasized the fact that the SEC was neither required to give ALJs any deference nor to use them at all in the first instance. Judge McKay also made explicit his concerns about the impact that the majority’s decision would have on the administrative state, noting the vast number of cases over which ALJs (in the SEC and elsewhere in government) preside every year. Each of those proceedings, Judge McKay worried, may now be open to challenge.

With a clear conflict between the Tenth Circuit and the D.C. Circuit regarding the constitutionality of SEC ALJs, the D.C. Circuit reheard Raymond J. Lucia en banc last May, explicitly asking the parties whether Landry should be overturned.[8] The court deadlocked — five judges would have granted the petition for review; five would not. The petition was denied, and the circuit split remains.

Implications of Supreme Court Review

Given the significance of the constitutional question at issue, and the fact that SEC ALJs now lack the constitutional authority to preside over the administrative proceedings in some regions of the country (but not others), the Supreme Court is overwhelmingly likely to resolve the conflict. If the court were to decide that the SEC’s ALJs were officers under the appointments clause and thus improperly appointed, courts will have to decide how to handle cases initially decided by ALJs, in addition to questions of waiver and finality. And the SEC may well bring more enforcement actions in federal court — at least until a cadre of properly appointed ALJs can be put into place.

Of course, the Supreme Court may conclude that the SEC’s ALJs are not officers. That result too would be significant: It would confirm the unique status of ALJs — members of the executive branch who

nonetheless exercise adjudicatory functions — in our administrative system and further clarify their role within the executive branch.

Regardless of the outcome, Supreme Court review and resolution of this issue would prove important. As Judge McKay recognized, the authority and duties of SEC ALJs are not unique to the SEC; ALJs in many other agencies exercise similar authority. Thus, the consequences of any Supreme Court decision addressing the status of ALJs under the appointments clause could apply broadly across government agencies.

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[1] 204 F.3d 1125 (D.C. Cir. 2000).

[2] 501 U.S. 868 (1991).

[3] 114 F. Supp. 3d 1297, 1318-19 (N.D. Ga. 2015).

[4] 2015 WL 4940057, at *2.

[5] The Second Circuit and Eleventh Circuit had previously decided appeals from Duka and Hill, respectively, but had held in both cases that the district court lacked jurisdiction over the claim. Those appellate decisions thus did not consider whether SEC ALJs were officers. See Tilton v. SEC, 824 F.3d 276 (2d Cir. 2016); Hill v. SEC, 825 F.3d 1236 (11th Cir. 2016).

[6] 832 F.3d at 285.

[7] 844 F.3d 1168 (10th Cir. 2016).

[8] The Tenth Circuit denied rehearing in Bandimere, 855 F.3d 1128 (10th Cir. 2017). Two judges dissented from that denial, asserting that the Bandimere majority improperly expanded Freytag's holding. Id. (Lucero, J., dissenting).
