Securities Litigation Update: Circuit Court Split over the Constitutionality of SEC Administrative Law Judges Tees Up Issue for the Supreme Court

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The Tenth and D.C. Circuit Courts of Appeal have come to opposite conclusions in response to constitutional challenges to the Securities Exchange Commission's (the "SEC's") appointment of Administrative Law Judges ("ALJs"). As detailed in our prior client alert, securities defendants across the country have contended that ALJs are inferior officers who were not appointed according to the Appointments Clause in Article II of the Constitution. The issue initially appeared settled when the D.C. Circuit held in *Lucia v. SEC*,[1] that ALJs were not officers subject to the requirements of the Appointments Clause. But, on December 27, 2016, the Tenth Circuit decided in *Bandimere v. SEC*[2] that ALJs were indeed inferior officers and therefore were in violation of the Appointments Clause. The Tenth Circuit's ruling, if ultimately upheld, has implications for pending and prior SEC actions, and may lead to similar questions about other agencies' administrative law judges. Given the circuit split, the constitutionality of the SEC's ALJ appointment process may be headed to the Supreme Court.

The Constitutional Challenge

The Appointments Clause provides that the President shall appoint officers of the United States, but that Congress may vest the appointment of inferior officers "in the President alone, in the Courts of Law, or in the Heads of Departments." In *Bandimere* and *Lucia*, securities law defendants argued that SEC ALJs are inferior officers, and because SEC ALJs are not appointed by SEC Commissioners, the President, or a court, they have been appointed in violation of the Appointments Clause.

The D.C. Circuit Sides with the SEC

The question presented by these challenges is whether ALJs are inferior officers, whose appointments are subject to the requirements of the Appointments Clause, or simply employees. In *Lucia*, the D.C. Circuit reasoned that one key difference between an inferior officer and an employee is that inferior officers have "final decision-making power." On this point, the D.C. Circuit was bound by its prior ruling in *Landry v. FDIC*,[3] which held that the Federal Deposit Insurance Corporation's ("FDIC's") ALJs were not inferior officers because they could not issue final decisions. Having previously emphasized that an official's ability to render final decisions was "critical" to the inferior officer inquiry, the D.C. Circuit found that because ALJs do not have final decision-making power, they were not inferior officers subject to the Appointments Clause.

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[1] 832 F.3d 277 (D.C. Cir. 2016).

[2] No. 15-9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016).

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

The Tenth Circuit Sides with Securities Defendants

In a split decision, the Tenth Circuit disagreed with the D.C. Circuit's position that final decision-making authority was a prerequisite for inferior officer status. Instead, it reasoned that the Supreme Court's decision in *Freytag v. Commissioner of Internal Revenue*,[4] which held that Tax Court special trial judges ("STJs") were inferior officers, did not depend on whether STJs had final decision-making authority: The Supreme Court "did not make final decision-making power the essence of inferior officer status." Following *Freytag*, the Tenth Circuit held that SEC ALJs were inferior officers because they hold duties comparable to the STJs in *Freytag* and because ALJs "exercis[e] significant authority pursuant to the laws of the United States."

In dissent, Judge McKay disagreed with the majority's reading of *Freytag*, and also expressed concern about what the ruling meant for SEC ALJs and administrative law judges more generally. The dissent contended that the majority's reasoning might also make all federal administrative law judges inferior officers and "effectively render[] invalid thousands of administrative actions." According to the dissent, the majority opinion "risks throwing much into disarray."

The Supreme Court Will Likely Decide

Unless the Tenth Circuit takes the case *en banc* to reverse course and erase the circuit split, the question presented by *Bandimere* and *Lucia* is a likely candidate for Supreme Court review. While it is impossible to predict whether the consequences will be as severe as those outlined in the *Bandimere* dissent, if the Supreme Court were to side with the Tenth Circuit, it will inject uncertainty into SEC administrative proceedings and create even more litigation.

[4] 501 U.S. 868 (1991).

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