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Circuits Split on Constitutionality of SEC Administrative Law Judges

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Securities Litigation and Enforcement

One piece of the ongoing debate over the Securities and Exchange Commission's use of Administrative Law Judges to adjudicate enforcement actions may be heading to the U.S. Supreme Court. On December 27, 2016, in *Bandimere v. SEC*,[1] the U.S. Court of Appeals for the Tenth Circuit invalidated SEC sanctions against an individual on the ground that the ALJ who presided over the proceeding was hired in violation of the U.S. Constitution's Appointments Clause. The decision directly conflicts with the D.C. Circuit's August 2016 decision in *Lucia v. SEC*.[2]

The Appointments Clause requires that "inferior officers" be appointed by the President, the courts, or the "head of department," whereas mere "employees" are not subject to that limitation.[3] SEC ALJs are hired by the Office of Personnel Management, with the hiring decision made by the SEC's Chief ALJ.[4] In a split decision, the Tenth Circuit held in *Bandimere* that SEC ALJs are "inferior officers" because their positions, duties, salaries, and means of appointment are specified by statute and because they have significant discretion in conducting hearings and issuing initial decisions in SEC administrative proceedings.[5] Thus, according to the majority, the SEC's current ALJ appointment system violates the Appointments Clause.[6] The dissent, in line with the D.C. Circuit, accepted the SEC's argument that ALJs are not inferior officers because they lack the power to issue a final decision.[7]

Having fought this far, it seems likely that the SEC would want to preserve the current ALJ hiring system and pursue Supreme Court review of the Tenth Circuit's decision. Because of the direct conflict with another Circuit on a matter affecting all SEC administrative cases, the Supreme Court would likely grant a petition for review. One question is whether the incoming Trump Administration would support a request by the SEC to ask the Supreme Court to hear an appeal of the case. Although the SEC has independent litigation authority in the lower courts, the Department of Justice, through the Solicitor General, represents the SEC before the Supreme Court.[8] Thus, it would ultimately be up to the Solicitor General whether to file a petition for *certiorari* in *Bandimere* and on what grounds.

Another question is what would happen if the SEC were to lose on this issue, either by a Supreme Court decision or through a determination by the Solicitor General not to seek Supreme Court review. Presumably, the SEC, as the "head of department," could eliminate any potential Appointments Clause violation in future administrative proceedings by re-hiring its ALJs directly. The SEC might also argue that this bureaucratic fix should be applied retroactively to pending proceedings, but respondents in those proceedings can be expected to argue that the proceedings should be dismissed because the presiding ALJ was unconstitutionally appointed when the proceeding was instituted. The SEC or the courts might draw a distinction for this purpose between pending proceedings in which ALJs have not yet

conducted hearings or issued initial decisions. This would be uncharted territory, which would probably have to be navigated through litigation.

In the meantime, in light of *Bandimere*, we expect the SEC to remain cautious about bringing enforcement actions before ALJs, especially in complex cases.[9] Clients facing a prospective or pending SEC administrative litigation should carefully consider how best to argue and preserve the Appointments Clause issue until it is resolved definitively.

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[1] *Bandimere v. SEC*, No. 15-9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016).
[2] *Raymond J. Lucia Companies, Inc. v. SEC*, 832 F.3d 277 (D.C. Cir. 2016).
[3] U.S. Constitution. art. II, § 2, cl. 2.
[4] 5 U.S.C. § 1302; 5 C.F.R. § 930.20.
[5] *Bandimere*, 2016 WL 7439007, at *10–12.
[6] *Id.* at *10.
[7] *Bandimere*, 2016 WL 7439007, at *23–24 (McKay, J., dissenting).
[8] *See* Neal Devins, *Unitariness and Independence: Solicitor General Control over Independent Agency Litigation*, 82 CAL. L. REV. 255, 272 (1994).
[9] David Kornblau & Sarah Mac Dougall, *SEC In-House Practice Going Back to 'Old Normal'*, Law360, https://www.law360.com/securities/articles/864301/sec-in-house-practice-going-back-to-old-normal- (Nov. 18, 2016).