

Supreme Court Finds SEC ALJ's Decision Unconstitutional

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By Stephanie Kao on September 17, 2018

As discussed last year, there was a Court of Appeals Circuit split as to whether the Securities and Exchange Commission (SEC)'s in-house administrative law judges ("ALJs") were officers that must be appointed pursuant to the Appointments Clause, or employees of the SEC that could continue to be hired through the government's civil service process. This key distinction would determine the constitutionality of SEC ALJ decisions. Please find my prior article [here](#).

On June 21, 2018, the Supreme Court of the United States issued its [decision](#) holding that SEC ALJs are officers and must be appointed pursuant to the Appointments Clause. *Lucia v. SEC*, 585 U.S. ____ (2018). The SEC brought the underlying action against Raymond Lucia and his marketing retirement savings strategy called "Buckets of Money." The SEC alleged that Mr. Lucia deceived prospective clients with misleading slideshow presentations and charged him with violating the Investment Advisers Act, §80b-1, *et seq.* The ALJ assigned to the case, Judge Cameron Elliot, issued an initial decision concluding that Mr. Lucia had violated the Investment Advisers Act, fined him civil penalties of \$300,000, and placed a lifetime bar on Mr. Lucia from the investment industry. Mr. Lucia's appeal challenging the constitutionality of the ALJ's decision was unsuccessful with the SEC and the Court of Appeals for the D.C. Circuit.

The Supreme Court's review of *Lucia* discusses the relevant factors for determining whether SEC ALJs are officers subject to the Appointments Clause. *Lucia* first states that for a position to have officer status, the position or individual must hold a continuing office established by law. *United States v. Germaine*, 99 U. S. 508, 511-512 (1879). Second, the individual must wield "significant authority." *Buckley v. Valeo*, 424 U. S. 1, 126 (1976). The *Lucia* Court then followed the analysis in *Freytag v. Commissioner*, 501 U.S. 868 (1991) for evaluating the "significant authority" test. The administrators in *Freytag* were special trial judges ("STJ") of the U.S. Tax Court and presided over narrow and minor matters. Once a STJ issued his or her proposed findings, it was up to a Tax Court judge to review and adopt the STJ's findings before it would be considered a final and binding decision. The court in *Freytag* held that STJs' duties were to "[t]ake testimony, conduct trials, rule on admissibility of evidence, and have the power to enforce compliance with discovery orders." *Id.* at 881-882. The *Lucia* Court held that ALJs have similar duties as STJs. *Lucia*, at 8-9. In addition, *Lucia* focused on ALJs' further independent role. *Id.* at 9-10. While all ALJ decisions can be reviewed by the SEC before being published, if the SEC declines to review the order the ALJ's decision becomes final and is deemed the action of the SEC. In light of the above analysis, the Supreme Court held that for ALJ's decisions to be valid, they must be appointed pursuant to the Appointment Clause. *Id.* at 10-11. Finally, the Supreme Court held that the appropriate remedy for Mr. Lucia is a new hearing before a properly appointed official, which cannot be the ALJ Judge who previously presided over Mr. Lucia's case. *Id.* at 12 - 13.

Given the recentness of *Lucia*, its impact on the SEC and other ALJs has yet to be fully determined. First, it is unclear how sitting SEC ALJs will be ratified or properly appointed. Second, the SEC's current proceedings have been stayed to determine handling going forward. Third, for defendants who were convicted by a SEC ALJ and did not timely challenge the constitutionality of the proceeding, it is unclear

how this ruling will impact those defendants, if at all. Finally, for the over 1,400 ALJs employed by numerous other U.S. Federal Agencies, very little can be gleaned from *Lucia* to provide a bright line rule to determine whether or not those ALJs need to be appointed by the Appointments Clause. Now that the Supreme Court has answered one burning legal question, many more have popped up.