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Lucia Will Not Address Essential Problem With SEC Court

By **Susan Brune** (January 29, 2018, 12:02 PM EST)

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Recent challenges to the system whereby administrative law judges are selected have coalesced into a grant of certiorari in Lucia v. U.S. Securities and Exchange Commission,[1] a case that would enable the U.S. Supreme Court to remake how ALJs are hired — and how they may be fired. If so, control over who serves as an ALJ will belong less to the Office of Personnel Management, or OPM, and employees of the various agencies that make up our nation's administrative system and more to the presidentially appointed members of the various commissions and heads of the agencies.

But while the decision may curtail the power of what certain presidential advisers have called with some disdain "the deep state" or "the administrative state,"[2] it will do little to address the essential problem: the lack of due process inherent in agencies' ability to bring significant cases in their own "courts."

Those hoping to become ALJs in any number of federal agencies need only click on the OPM's website to get their judicial careers underway. As part of the application process, applicants take examinations that the OPM's website currently describes as "a multi-part assessment of relevant competencies, through the use of online, proctored and in-person assessments." The examination does not test the applicants' agency-specific level of knowledge. Instead, as the OPM helpfully explains, "[b]y applying for the ALJ examination, applicants are essentially applying to be placed on a register (i.e., a list of eligibles), not for a specific job at a specific agency." Then, when there are openings for ALJ positions, OPM makes referrals "to agencies for employment consideration when they have entry level ALJ vacancies to fill."[3]

At the SEC, the sitting chief ALJ selects each new ALJ from among the top three candidates as ranked by the OPM.[4] Each ALJ is empowered to adjudicate administrative cases via "initial decisions" reviewable in the first instance by the commission itself. This long-standing system enables the commission to elect to bring cases either in federal court or in an administrative "courtroom" presided over by an SEC employee and reviewable at the first level only by the commission itself. The commission has unfettered discretion in choosing between forums, opening itself to the criticism that it can funnel and has funneled weaker cases to its own court system, where it almost never loses.[5]

In the past, the SEC has defended its administrative court system by noting that it is "streamlined."[6] Indeed it is — and the streamlining comes from the fact that individual respondents get significantly less in the way of due process protection. Deprived of a jury and of a judicial officer truly independent of

their adversary, litigants doubt — with good reason — whether they can get a fair shake before an ALJ. The recent challenges to this system may end up having broad implications and perhaps not precisely the ones intended.

In April 2015, our client, private equity investor Lynn Tilton, brought the very first challenge to how ALJs were selected. In pursuit of the due process protections available in federal court, she contended that the ALJ presiding over the enforcement case that the SEC had brought against her was hired through a method that did not comport with the requirements of the Constitution's appointments clause.[7] In particular, ALJs are, so her complaint against the SEC alleged, "inferior officers" — not mere "employees" — and as such should be appointed by the commission itself, rather than simply hired via the OPM system. The government defended the SEC's position that its method of appointing its powerful ALJ "employees" was proper. Tilton pursued the issue all the way to the Supreme Court, which declined to review the Second Circuit's ruling that it did not have subject matter jurisdiction because she had not yet been subjected to a trial in front of an ALJ.[8]

Her challenge having been shut down at least for the moment, Tilton was forced to proceed to trial before an SEC ALJ. After a month-long trial, the ALJ found in her favor, dismissing all charges.[9] Given that the ALJ's findings were so resoundingly in Tilton's favor, the SEC enforcement staff did not appeal the outcome. Having obtained a complete vindication in the SEC's own court, Tilton had no basis to continue to pursue her objection to the method by which the presiding ALJ had been selected.

Soon after Tilton brought her challenge, though, several other individuals began litigating challenges to the ALJ system based on the same legal theory. As it had with Tilton, the government opposed with vigor.

Raymond J. Lucia, an investment adviser, was one such litigant. Unlike Tilton, Lucia had already submitted to a trial before an ALJ and had lost. There was thus no issue as to whether his claims were ripe, and, as a consequence, he was well-positioned for appellate review. In August 2016, the D.C. Circuit ruled against Lucia. He filed for certiorari after the D.C. Circuit, sitting en banc, split 5-5 in June 2017.

On Nov. 29, 2017, the solicitor general, reversing his office's previous positions in Lucia's case and other similar ones, filed a brief in support of Lucia's petition for review. As the solicitor general wrote: "Upon further consideration, and in light of the implications for the exercise of executive power under Article II, the government is now of the view that such ALJs are officers because they exercise 'significant authority pursuant to the laws of the United States.'"[10] The SEC was left on its own; the solicitor general suggested that the court "appoint an amicus curiae to defend the judgment below."[11]

The day after the solicitor general filed his brief, the commission summarily "ratified" its prior appointments of ALJs — whatever that means.[12] In its accompanying press release, the SEC claimed that "[b]y ratifying the appointment of its ALJs, the Commission has resolved any concerns that administrative proceedings presided over by its ALJs violate the Appointments Clause."[13]

On Jan. 12, 2018, the Supreme Court granted certiorari in Lucia.

The Supreme Court's ruling will turn on whether ALJs are mere employees or "inferior officers" who must be appointed by the relevant agency. The SEC will face an uphill battle. Its ALJs have the authority to administer oaths; to issue, revoke, quash or modify subpoenas; to receive, and rule on, the admission of evidence; to withhold a party's access to agency documents; to decide motions; to exclude

contemnors from the proceedings; to deem parties to be in default; and to adjudicate the facts and law via initial decisions. Those initial decisions may include significant sanctions, including substantial fines, orders requiring substantial disgorgement, and lifetime industry bars.[14] (Indeed, in Tilton's case, the SEC unsuccessfully sought well over $200 million in disgorgement and unspecified fines, in addition to an industry bar.)

There can be no suggestion that the Supreme Court's decision will be limited to SEC ALJs. As the solicitor general's brief stated, review was warranted because how ALJs must be appointed "affects not merely the Commission's enforcement of the federal securities laws, but also the conduct of adversarial administrative proceedings in other agencies within the government."[15] Agencies that could be affected include the U.S. Environmental Protection Agency, the National Labor Relations Board, the Federal Communications Commission, and the U.S. Commodity Futures Trading Commission, to name a few.[16]

Notably, the solicitor general argued that the Supreme Court should accept Lucia's case because the court's guidance was "necessary to enable the United States to assess the status of ALJs in various roles across government and to consider whether the rules governing the selection *and removal* of those officials comport with constitutional requirements."[17] The solicitor general will be arguing that ALJs should not be insulated from firing via tenure protection. (Presently, ALJs can be removed only for good cause, and only by the Merit Systems Protection Board.[18] Members of the board, in turn, can be removed only by the president and only for good cause.[19]) According to the solicitor general, "It is critically important that the Court, in considering whether the Commission's ALJs are 'Officers of the United States,' address whether the restrictions imposed by statute on their removal are consistent with the constitutionally prescribed separation of powers."[20]

In other words, if the Supreme Court rules for Lucia, ALJs will no longer be shielded from the power of the executive branch. Depending on your political perspective and your views about our current president, that may or may not be a positive change. But regardless of who is wielding the power to appoint and remove ALJs, individuals and companies will continue to be at risk of adverse adjudications without full due process protections. And that is not a good thing.

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DISCLOSURE: The author represented Tilton in the cases discussed here.

[1] Raymond J. Lucia Cos. v. SEC, 868 F.3d 1021 (D.C. Cir. 2017) (en banc) (per curiam), cert. granted sub nom. Lucia v. SEC, No. 17-130, 2018 WL 386565 (U.S. Jan. 12, 2018). The D.C. Circuit set up a circuit split, coming on the heels of a Tenth Circuit decision holding that ALJs were "inferior officers" subject to the appointments clause. Bandimere v. SEC, 844 F.3d 1168 (10th Cir. 2016), reh'g denied, 855 F.3d 1128 (May 3, 2017).

[2] Julie Hirschfeld Davis, Rumblings of a 'Deep State' Undermining Trump? It was Once a Foreign Concept, N.Y. Times, Mar. 6, 2017, https://www.nytimes.com/2017/03/06/us/politics/deep-state-trump.html.

[3] New Release, U.S. Office of Personnel Management, Statement from the U.S. Office of Personnel Management Regarding the 2017 Administrative Law Judge Examination (Aug. 3, 2017), available at https://www.opm.gov/news/releases/2017/08/statement-from-the-us-office-of-personnel-management-regarding-the-2017-administrative-law-judge-examination-1/.

[4] 5 U.S.C. § 3317(a), 3318(a). Alternatively, they may select ALJs with existing appointments from another agency. 5 C.F.R. 2.2(a).

[5] In response to criticism, the SEC has announced the "factors" that it says it takes into account as it exercises its discretion. Andrew Ceresney, Director, SEC Division of Enforcement, Keynote Speech at New York City Bar 4th Annual White Collar Institute (May 12, 2015), available at https://www.sec.gov/news/speech/ceresney-nyc-bar-4th-white-collar-key-note.html.

[6] Mary Jo White, Chair, SEC, A New Model for SEC Enforcement: Producing Bold and Unrelenting Results (Nov. 18, 2016), available at https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html ("Administrative proceedings offer a fair and efficient way to determine liability for potential violations through streamlined proceedings ultimately adjudicated by the Commission and reviewable by a Court of Appeals.").

[7] Tilton et al. v. SEC, No. 15-cv-2472, 2015 WL 4006165 (SDNY June 30, 2015), aff'd, 824 F.3d 276 (2d Cir. 2016), cert. denied,137 S. Ct. 2187 (2017).

[8] Tilton et al. v. SEC, 824 F.3d 276 (2d Cir. 2016), cert. denied,137 S. Ct. 2187 (2017).

[9] In re Lynn Tilton, Initial Decision Release No. 1182 (Sept. 27, 2017).

[10] Brief for the Respondent at 9-10, Lucia v. SEC, 2018 WL 386565 (U.S. Jan. 12, 2018) (No. 17-130) (quoting Buckley v. Valeo, 424 U.S. 1, 126 (1976) (per curiam)).

[11] Id. at 10.

[12] In re Pending Administrative Proceedings, Securities Act Release No. 10,440, Exchange Act Release No. 82178, Investment Advisers Act Release No. 4816, Investment Company Act Release No. 32929 (Nov. 30, 2017).

[13] SEC Ratifies Appointment of Administrative Law Judges (Release No. 17-215).

[14] Office of Administrative Law Judges, U.S. Sec. & Exch. Comm'n (Jan. 26, 2017), https://www.sec.gov/alj.

[15] Brief for the Respondent at 10, Lucia, 2018 WL 386565 (No. 17-130).

[16] Indeed, the dissenting judge in Bandimere noted his concern about the implications of the decision. "Despite the majority's protestations, its holding is quite sweeping, and I worry that it has effectively rendered invalid thousands of administrative actions." 844 F.3d at 1199 (McKay, J., dissenting).

[17] Brief for the Respondent at 18, Lucia, 2018 WL 386565 (No. 17-130) (emphasis added).

[18] 5 USC 7521(a).

[19] 5 USC § 1202(d) (members of the Merit Systems Protection Board "may be removed by the President only for inefficiency, neglect of duty, or malfeasance in office").

[20] Brief for the Respondent at 21, Lucia, 2018 WL 386565 (No. 17-130).