



U.S. Supreme Court Holds SEC's Staff Appointments for Administrative Law Judge Unconstitutional

In *Lucia v. SEC*, the U.S. Supreme Court made things messy for the Securities and Exchange Commission ("SEC") by vindicating constitutional concerns over the agency's use of administrative law judges. The Court concluded that SEC administrative law judges ("ALJs") are "Officers of the United States" under the Constitution's Appointments Clause, Art. II, §2, cl. 2. They therefore must be directly appointed by the President, courts, or heads of agencies rather than agency staff.

The Court held that *Freytag v. Commissioner*, a case concluding that special trial judges of the U.S. Tax Court were Officers of the United States, was controlling. The special trial judges of the U.S. Tax Court had essentially all the tools of Article III judges to conduct quasi-judicial proceedings, including exercising significant discretion in taking testimony, conducting trials, ruling on evidence admissibility, and enforcing discovery orders. SEC ALJs, the Court explained, have essentially the same functions and powers as *Freytag's* special trial judges. If anything, SEC ALJs have more power because their recommended decisions can become final if the Commission declines to review them.

In *Lucia*, the SEC ALJ who decided the case at issue was appointed by SEC staff. The petitioner made a timely challenge to the constitutional validity of the officer who adjudicated his case and pursued the constitutional challenge at every stage of the litigation. The Court therefore remanded for a new hearing before a properly appointed ALJ, specifying that the matter should not be heard by the ALJ who originally presided over the case.

While this litigation was pending, the Commission ratified the prior appointments of each of the five SEC ALJs, thereby attempting to satisfy Appointments Clause requirements for future administrative adjudication. Following the decision, the Commission ordered that pending administrative proceeding be stayed for at least 30 days. As a result of the Court's decision, particularly in light of the remand for a new hearing before a properly appointed ALJ, we expect to see challenges to prior ALJ adjudication, with a focus on whether Appointments Clause challenges have been properly preserved.

Lucia has not fully resolved the constitutional challenges to SEC ALJs. Despite urging from the government, the Court declined to consider in this case whether statutory restrictions on removing SEC ALJs are constitutional. The Administrative Procedure Act mandates that SEC ALJs may be removed only "for cause." SEC ALJs report to the Commission, whose members also may only be removed "for cause." At issue is whether these multiple layers of protection from removal by the President is unconstitutional.

Although administrative proceedings are currently stayed and may be disfavored even after the stays are lifted, in the longer term, and under a future Commission, we may ultimately see an increase in adjudication before SEC ALJs, once the Court fully resolves the constitutional challenges that have been lingering over SEC administrative proceedings.



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