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Bandimere v. SEC: Significant Authority Exists Without Finality

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Bandimere v. SEC: Significant Authority Exists Without Finality

I. Introduction

"Liberty requires accountability."[1]

The Framers of the Constitution could not have imagined our sprawling administrative system, which "wields vast power and touches almost every aspect of daily life."[2] Nor could they have envisioned executive branch officials called "administrative law judges" (ALJs) issuing decisions and distributing punishment to citizens that violate the law. But they were keenly aware of the threat posed by an unaccountable government—that "widely distributed appointment power subverts democratic government" by preventing citizens from tracing government action to an accountable, elected leader.[3] In fact, the founders noted that when the appointment power is dispersed among multiple people, "[s]candalous appointments to important offices" are made, making it difficult "to determine by whose influence [the people's] interests have been committed to hands so unqualified and so manifestly improper."[4] Accordingly, the framers created a structural safeguard against unaccountable administration: the Appointments Clause of the Constitution, which requires that any officer of the United States be appointed by the President, the head of a department, or a court of law.[5]

By "limiting the appointment power" to a specified set of actors known to the public, the Appointments Clause guarantees that administrators entrusted with significant power are "accountable to political force and the will of the people."[6] The Securities Exchange Commission (SEC) ALJs wield far-reaching, coercive powers—they preside over hearings, "rule on the admissibility [and credibility] of evidence," and issue opinions.[7] Yet, SEC ALJs are protected from direct control by the electorate because they are not appointed by the President, the head of the SEC, or a court of law.[8] To date, the issue of whether ALJs are officers within the meaning of the

1. Dep't of Transp. v. Ass'n of Am. R.Rs., 135 S. Ct. 1225, 1234 (2015) (Alito, J., concurring).
2. Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 499 (2010).
3. Freytag v. Comm'r, 501 U.S. 868, 885 (1991).
4. THE FEDERALIST NO. 70, at 408 (Alexander Hamilton) (ABA ed., 2009).
5. U.S. CONST. art. II, § 2, cl. 2.
6. *Freytag*, 501 U.S. at 884.
7. *Id.* at 868, 881-82.
8. 5 U.S.C. § 1302 (2012); 5 C.F.R. § 930.201 (2018).

Appointments Clause has sharply divided the federal courts of appeals.[9] In *Raymond J. Lucia Companies, Inc. v. SEC*, the United States Court of Appeals for the District of Columbia Circuit held that SEC ALJs are not subject to Appointments Clause requirements because they are "employees," not "inferior officers," and can thus be hired through a competitive process overseen by the Office of Personnel Management (OPM).[10] In contrast, the recent decision by the Tenth Circuit Court of Appeals in *Bandimere v. SEC* held that SEC ALJs are "inferior officers" because they exercise significant discretion, and so they must be appointed as dictated by the Appointments Clause.[11] The D.C. Circuit's ruling against Lucia stands in direct conflict with the Tenth Circuit ruling in *Bandimere*. Both Bandimere and Lucia filed petitions for certiorari.[12] The Supreme Court granted Lucia's petition because it was a better vehicle to decide the issue. *Lucia* was likely preferable over *Bandimere* because Justice Gorsuch was still a judge on the Tenth Circuit when the SEC asked for a rehearing en banc of the *Bandimere* decision.[13]

By granting Lucia's petition for certiorari,[14] the Supreme Court indicated that ensuring ALJs are constitutionally appointed is now more important than ever. Since the Dodd-Frank Act was passed in 2010, there has been a dramatic increase in actions brought as administrative proceedings before ALJs rather than as civil actions in court.[15] This increase occurred because

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9. *See, e.g.*, Raymond J. Lucia Cos., Inc. v. SEC, 832 F.3d 277 (D.C. Cir. 2016), *rev'd sub nom.* Lucia v. SEC, 138 S. Ct. 2044 (2018); SEC v. Bandimere, 844 F.3d 1168 (10th Cir. 2016), *cert. denied*, 138 S. Ct. 2706 (2018).

10. 832 F.3d 277 (D.C. Cir. 2016), *rev'd sub nom.* Lucia v. SEC, 138 S. Ct. 2044 (2018).

11. 844 F.3d 1168 (10th Cir. 2016), *reh'g en banc denied*, 855 F.3d 1128 (10th Cir. 2017), *cert. denied*, 138 S. Ct. 2706 (2018).

12. Petition for a Writ of Certiorari, *Lucia*, 832 F.3d 277 (No. 17-130); Petition for Writ of Certiorari, *Bandimere*, 844 F.3d 1168 (No. 17-475).

13. *See* Brief for Amici Curiae Raymond J. Lucia in Support of Neither Party at 5-7, *Bandimere*, 844 F.3d 1168 (No. 17-475).

14. Lucia v. SEC, 868 F.3d 1021 (D.C. Cir. 2017), *rev'd*, 138 S. Ct. 2044 (2018).

15. "Prior to the passage of the Dodd-Frank Act in 2010, the SEC historically brought approximately 60 percent of its new cases as administrative proceedings. In contrast, over 80 percent of the new enforcement actions in the first half of fiscal year 2015 were filed as administrative proceedings." Sara Gilley, Heather Lazur & Alberto Vargas, *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW 360 (May 27, 2015), https://www.cornerstone.com/Publications/Articles/2015-Midyear-Checkup-on-SEC-Administrative-Proceedings; *see also SEC Enforcement Activity—First Half FY 2017 Update*, CORNERSTONE RES., https://www.cornerstone.com/Publications/Research/SEC-Enforcement-Activity-First-Half-FY-2017-Update (last visited Feb. 13, 2018).

the Dodd-Frank Act provided wider discretion in forum selection.[16] Because of this recent surge in administrative proceedings, the constitutionality of ALJs has become increasingly important. The rise in administrative proceedings appropriately carries with it a more prominent role in agency policymaking on the part of ALJs.[17] It also shifts responsibility for construing and interpreting the securities laws from federal courts to ALJs, because federal courts reviewing administrative decisions defer to ALJ decisions.[18] "Any [individual] with such ample policymaking" influence should ultimately "be accountable to the will of the people through their elected officials."[19] In light of the increasingly central role that SEC ALJs have in adjudicating enforcement actions and molding the policy and law governing individuals and businesses, it is imperative that the structural safeguards provided by the Appointments Clause allow the public to easily identify and hold accountable the officials responsible for appointing the ALJs.

Reversing the D.C. Circuit, the Supreme Court agreed with *the Tenth Circuit,* finding that SEC ALJs are "inferior officers."[20] Critics of the Tenth Circuit's decision in *Bandimere* and the Supreme Court's decision in *Lucia* have argued that because SEC ALJs were found to have held their positions in violation of the Constitution, then potentially hundreds (if not thousands) of prior SEC decisions are in jeopardy of being invalidated.[21] In addition, as Judge McKay pointed out in his *Bandimere* dissent, a finding that SEC ALJs are "inferior officers" could potentially mean that "all federal ALJs are at risk of being declared inferior officers."[22] This Note argues that these concerns are unwarranted and exaggerated. Even if a ruling that SEC ALJs are "inferior officers" would disrupt the administrative system, the "fact that a given law or procedure is efficient, convenient, and useful in

16. Gilley, Lazur & Vargas, *supra* note 15.

17. *See* Philip J. Griffin, Comment, *Developments in SEC Administrative Proceedings: An Evaluation of Recent Appointment Clause Challenges, the Rapidly Evolving Judicial Landscape, and the SEC's Response to Critics*, 19 U. PA. J. BUS. L. 209, 218-19 (2016); Joseph A. Grundfest, *Fair or Foul?: SEC Administrative Proceedings and Prospects for Reform Through Removal Legislation*, 85 FORDHAM L. REV. 1143, 1165-66 (2016).

18. Griffin, *supra* note 17, at 218-19; *see also* Grundfest, *supra* note 17, at 1166-67.

19. Michael A. Carvin, Noel J. Francisco & Christian G. Vergonis, *Massive, Unchecked Power by Design: The Unconstitutional Exercise of Executive Authority by the Public Company Accounting Oversight Board*, 4 N.Y.U. J.L. & BUS. 199, 214 (2007).

20. Lucia v. SEC, 138 S. Ct. 2044, 2055 (2018).

21. Bandimere v. SEC, 844 F.3d 1688, 1199-1201 (10th Cir. 2016) (McKay, J., dissenting).

22. *Id.* at 1199.

facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution," for "[c]onvenience and efficiency are not the primary objectives—or the hallmarks—of democratic government."[23]

By subjecting citizens to punishment imposed by an ALJ that was not appointed by a politically accountable officer, the SEC denies one of the "long term, structural protections against abuse of power" that the Framers believed "critical to preserving liberty."[24] In addition, by channeling enforcement actions to unaccountable ALJs, the SEC brings us closer to a "government . . . ruled by functionaries" instead of officers appointed by elected leaders accountable to the people.[25] "It would be a bit much to describe the result as 'the very definition of tyranny,' but the danger posed by the growing power of the administrative state cannot be dismissed."[26]

II. Law Before the Case

A. An Overview of the SEC and Administrative Proceedings

The SEC is an independent agency with five commissioners, all appointed by the President and subject to Senate approval.[27] To promote integrity in the securities markets, the Securities Exchange Act of 1934 (Exchange Act) established a system of administrative supervision, regulation of certain industry practices, and mandatory disclosure requirements for companies whose securities were publicly traded on stock exchanges.[28] To execute this program, the Exchange Act created the SEC and empowered it to enforce federal securities laws.[29] The SEC may bring enforcement actions in federal court or in an administrative proceeding.[30] The SEC derives its power to bring administrative enforcement actions from The Administrative Procedure Act (APA), which authorizes agencies to conduct in-house administrative proceedings before an ALJ.[31]

An SEC administrative proceeding is an "in-house adjudication," tried before an ALJ, who renders an initial decision.[32] Either the defendant or the

23. Bowshar v. Synar, 478 U.S. 714, 736 (1986) (quoting INS v. Chadha, 462 U.S. 919, 944 (1983)).
24. *Id.* at 730.
25. Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 499 (2010).
26. City of Arlington v. FCC, 569 U.S. 290, 315 (2013) (Roberts, C.J., dissenting).
27. 15 U.S.C. § 78d(a) (2012).
28. *See generally* Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78pp (2012).
29. *See id.* § 78d(a).
30. *See id.* §§ 78u(d)(1), 78u–1 to –3.
31. 5 U.S.C. § 3105 (2012).
32. 17 C.F.R. § 201.360 (2018).

SEC can appeal the initial decision to the Commission itself.[33] An appeal is subject to de novo review by the Commissioners who can affirm, reverse, modify, or remand the ALJ's decision.[34] If the SEC declines to review or fails to review in a timely manner, however, the ALJ's decision becomes the final decision of the SEC.[35] If the SEC issues a decision unfavorable to the appellee, that party may appeal to the United States Court of Appeals within sixty days of the date the SEC entered its final order.[36]

B. The SEC and the Dodd-Frank Act

The passage of the Dodd-Frank Act in 2010 gave the SEC more power to bring significant administrative actions. The Dodd-Frank Act expanded the SEC's ability to use administrative proceedings for enforcement purposes by allowing them to initiate cases against non-regulated entities or persons.[37] The Act also provided the SEC "sole discretion" to decide whether it should bring the case in an administrative proceeding or in federal court.[38] With this expansion of jurisdiction, ALJs may deliver sanctions including cease-and-desist orders, disbarments, and large civil penalties that have become powerful offensive weapons adversely affecting a much larger group of people.[39]

After the enactment of the Dodd-Frank Act, the use of the administrative process for SEC proceedings increased.[40] Generally speaking, because of the significant differences between administrative actions and those filed in federal court, there exists a noteworthy "home-court advantage" to the administrative arena.[41] Because discovery is limited, and the proceedings move forward swiftly, it can be much more difficult for a responding party to develop the facts or mount an affirmative defense.[42] Additionally, there is

33. *Id.* § 201.410.

34. *Id.* §§ 201.411(a), 201.452.

35. *Id.* § 201.411.

36. 15 U.S.C. § 78y(a)(1); 17 C.F.R. § 201.410(e).

37. Geoffrey F. Aronow, *Back to the Future: The Use of Administrative Proceedings for Enforcement at the CFTC and SEC*, FUTURES & DERIVATIVES L. REP., Jan.–Feb. 2015, at 1, 1.

38. *Id.* at 3.

39. David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1170 (2016).

40. Lisa Newman, *Are SEC Administrative Proceedings the New [Unconstitutional] Normal?*, 36 REV. LITIG. 193, 201-02 (2017).

41. Zaring, *supra* note 39, at 1175.

42. Douglas Davison et al., *Litigating with—and at—the SEC*, 48 REV. SEC. & COMMODITIES REG. 103, 108 (2015).

no procedure available for a responding party to seek dismissal of the allegations at the outset of the case—that opportunity is available only to defendants in federal court.[43] For these reasons, the SEC unsurprisingly enjoys a higher rate of success in administrative proceedings than in federal court. For example, in the fiscal year ending on September 30, 2014, the SEC won 100% of its internal administrative hearings, while winning only 61% of its trials in federal court.[44]

C. The SEC ALJs

An SEC administrative enforcement proceeding is "presided over by one of the five SEC ALJs."[45] Currently, the presiding ALJ is technically an employee of the SEC.[46] Nevertheless, the ALJ purportedly acts neutrally and impartially when making decisions, even though the SEC is a party to the proceeding. To preserve independence between the SEC and the ALJ, the APA provides several safeguards.

First, the ALJs are hired through the Office of Professional Management (OPM).[47] The OPM prequalifies individuals, which means that the ALJ applicants who meet the office's qualification standards must pass an examination.[48] The SEC's Chief ALJ "then select[s] an ALJ from the top three" candidates.[49] This rigorous selection process represents just one of the procedural safeguards designed to promote independence between ALJs and the SEC.[50] Second, ALJs are exempt from the annual performance ratings to which other employees are subjected.[51] OPM regulations also provide that "[a]n agency may not rate the job performance of an administrative law judge," or grant "monetary or honorary awards or incentives" to ALJs.[52] Third, once hired, ALJs receive career appointment, meaning they can be fired, suspended, or given a reduction in pay only "for good cause established and determined" after a hearing in front of the Merit

43. *Id.*

44. Newman, *supra* note 40, at 195.

45. Kaela Dahan, Note, *The Constitutionality of SEC Administrative Proceedings: The SEC Should Cure Its ALJ Appointment Scheme*, 38 CARDOZO L. REV. 1211, 1215 (2017).

46. *See* Zaring, *supra* note 39, at 1165.

47. 5 U.S.C. § 1302 (2012); 5 C.F.R. § 930.201 (2018).

48. 5 C.F.R. § 930.204.

49. VANESSA K. BURROWS, CONG. RESEARCH SERV., RL34607, ADMINISTRATIVE LAW JUDGES: AN OVERVIEW 2 (2010), https://perma.cc/T8YY-EE7F.

50. *Id.* at 7.

51. 5 U.S.C. § 4301(2)(D) (2012).

52. 5 C.F.R. § 930.206.

Systems Protection Board.[53] Under this removal structure, three layers of insulation protect these ALJs from removal by the President.[54]

D. The Appointments Clause and the Distinction Between "Employees" and "Inferior Officers"

When an ALJ presides over an SEC enforcement action, the ALJ, in essence, operates no differently than a federal judge—they must remain independent, ethical, and impartial towards the litigating parties.[55] Nonetheless, until recently, the prevailing idea was that SEC ALJs are "employees" rather than "officers."[56] The current appointment process of SEC ALJs is permitted because of this employee designation.[57] However, because the Dodd-Frank Act tremendously enlarged the quasi-judicial role of SEC ALJs, now they more closely resemble "inferior officers" than employees.[58] This means that they should be appointed in compliance with the Appointments Clause, which provides that:

> [The President] ... shall nominate, and by and with the Advice and Consent of the Senate, shall appoint ... Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[59]

The Supreme Court has repeatedly emphasized the importance of the Appointments Clause, noting that it is "among the significant structural safeguards of the constitutional scheme. . . designed to preserve political accountability relative to important Government assignments."[60] By failing to designate SEC ALJs as "officers," Congress has "mask[ed], under complicated and indirect measures, the encroachments which it makes on the co-ordinate departments, and thus control[s] the nominal actions (*e.g.*,

53. 5 U.S.C. § 7521 (2012).

54. Zaring, *supra* note 39, at 1192.

55. Butz v. Economou, 438 U.S. 478, 513 (1978) ("There can be little doubt that the role of the modern federal . . . ALJ . . . is 'functionally comparable' to that of a judge.").

56. *See* 5 C.F.R. §§ 930.201-11.

57. Lucia v. SEC, 832 F.3d 277, 289 (D.C. Cir. 2016), *rev'd*, 138 S. Ct. 2044 (2018).

58. Giles D. Beal IV, *Judge, Jury, and Executioner: SEC Administrative Law Judges Post-Dodd Frank*, 20 N.C. BANKING INST. 413, 423 (2016).

59. U.S. CONST., art. II, § 2, cl. 2.

60. Edmond v. United States, 520 U.S. 651, 655, 663 (1997).

appointments) of the other branches."[61] Thus, by removing the power to appoint officers from the President (or department heads or courts of law), Congress has commandeered executive power—a danger the Framers aimed to prevent.[62] By removing the power of the executive branch to appoint officers, Congress consequently removes the accountability safeguards of the executive branch. Citizens must be able to easily identify the source of legislation or regulation that impacts their lives to prevent Government officials from wielding power without ownership of the consequences.[63]

E. Recent Case Law

Modern jurisprudence has had difficulty distinguishing "employees" from "inferior officers." The most recent Supreme Court case to address this issue is *Freytag v. Commissioner of Internal Revenue*.[64] In *Freytag*, the Supreme Court analyzed whether the Tax Court possessed the authority to appoint special trial judges (STJs) under the Appointments Clause.[65] As a threshold matter, the Supreme Court determined whether STJs were "inferior officers" by focusing on three factors.[66] First, the position of the STJ was established by law.[67] Second, "the duties, salary and means of appointment" of the STJ were established by statute.[68] Third, the STJs exercise significant discretion in carrying out important non-ministerial functions.[69] The *Freytag* Court noted that even though STJs do not have the authority to render final decisions, they still exercise significant discretion in carrying out important functions such as taking testimony, ruling on evidence, conducting trials, and "enforcing compliance with discovery orders."[70] Therefore, the Court concluded that STJs were "inferior Officers" rather than "employees."[71]

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61. Freytag v. Comm'r, 501 U.S. 868, 906 (1991) (Scalia, J., concurring in part and concurring in the judgment).

62. Brief for Pac. Legal Found. as Amicus Curiae Supporting Petitioners at 9-10, *Lucia*, 832 F.3d 277 (No. 17-130), 2017 WL 3725916, at *9-10.

63. Dep't of Transp. v. Ass'n of Am. R.Rs., 135 S. Ct. 1225, 1234 (2015) (Alito, J., concurring).

64. 501 U.S. 868 (1991).

65. *Id.* at 872-73.

66. *Id.* at 881.

67. *Id.*

68. *Id.*

69. *Id.* at 881-82.

70. *Id.*

71. *Id.* at 882.

Despite *Freytag*'s holding that final decision-making authority was not a dispositive element, in *Landry v. FDIC*, the Court of Appeals for the District of Columbia emphasized this component in holding that the Federal Deposit Insurance Corporation (FDIC) ALJs were "employees" and not "inferior officers."[72] The *Landry* majority noted that the STJs in *Freytag* had "authority to render the *final* decision of the Tax Court in declaratory judgment proceedings and in certain small-amount tax cases."[73] The court contrasted this with the role of FDIC ALJs; noting that although the FDIC ALJs can recommend fact-finding determinations, legal conclusions, and ultimate decisions, the ALJs cannot make final decisions for the FDIC.[74] Therefore, the court concluded that FDIC ALJs were not "inferior officers."[75]

Lucia was the first case to address whether the SEC ALJs are "employees" or "inferior officers."[76] The D.C. Circuit held that SEC ALJs were "employees," creating a clear circuit split from the Tenth Circuit's decision in *Bandimere*.[77] The court veered away from the three-part test formulated in *Freytag* and invoked a different approach to determine whether SEC ALJs exercise significant discretion in carrying out important functions.[78] The court indicated that once an appointee meets the two threshold requirements—that the relevant position was established by law and the position's duties, salary, and means of appointment are set forth in a statute[79]—then "the main criteria for drawing the line between inferior officers and employees . . . are (1) the significance of the matters resolved by the officials, (2) the discretion they exercise in reaching their decisions, and (3) the finality of those decisions."[80] Following this framework, the D.C. Circuit held that because SEC ALJs can only recommend enforcement action and do not have the congressional authority to "bind third parties," the third element of this analysis was not satisfied.[81] Accordingly, a three-judge panel ruled that SEC ALJs are "employees."[82] Lucia subsequently

72. 204 F.3d 1125, 1134 (D.C. Cir. 2000).
73. *Id.* at 1133.
74. *Id.*
75. *Id.* at 1134.
76. *See* Lucia v. SEC, 832 F.3d 277, 283 (D.C. Cir. 2016).
77. *Id.*
78. *See id.* at 284; Freytag v. Comm'r, 501 U.S. 868, 881–82 (1991).
79. *Lucia*, 832 F.3d at 284 (citing Landry v. FDIC, 204 F.3d 1125, 1133-34 (D.C. Cir. 2000)).
80. *Id.* (quoting Tucker v. Comm'r, 676 F.3d 1129, 1133 (D.C. Cir. 2012)).
81. *Id.* at 286.
82. *See id.*

petitioned the D.C. Circuit for en banc review. However, the circuit split was preserved after the *Lucia* court split evenly when reviewing the case en banc, effectively affirming its earlier decision.[83]

The disagreement between the D.C. Circuit and the Tenth Circuit reflects the conflicting outlooks on what it means to exercise "significant authority." On one hand, according to the D.C. Circuit, SEC ALJs can only exercise "significant authority" by rendering a final decision.[84] On the other hand, according to the Tenth Circuit, "significant authority" can be exercised solely by influencing the outcomes of SEC enforcement actions.[85]

III. Statement of the Case

In 2012, the SEC brought an administrative action against Colorado businessman, David Bandimere, for violating various securities laws.[86] An ALJ conducted a hearing and issued an initial decision that found Bandimere liable for securities fraud, barred him from the securities industry, ordered him to disgorge the funds he received, and imposed civil penalties.[87] The SEC reviewed the ALJ's initial decision and issued a separate opinion affirming the result.[88] Bandimere then petitioned the Tenth Circuit Court of Appeals to review the SEC's order.[89] In his petition, Bandimere argued that the SEC process of hiring ALJs was an unconstitutional violation of the Appointments Clause, and therefore the ALJ had no lawful authority to preside over his case.[90] Diverging from other federal courts, the Tenth Circuit set aside the SEC's decision, holding that the appointment of the ALJ who presided over Bandimere's hearing was not consistent with the requirements of the Appointments Clause.[91]

83. Lucia v. SEC, 868 F.3d 1021, 1021 (D.C. Cir. 2017), *aff'g en banc* 832 F.3d 277 (D.C. Cir. 2016).

84. *Id.*

85. Bandimere v. SEC, 844 F.3d 1168, 1182-84 (10th Cir. 2016).

86. *Id.* at 1171.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* at 1170.

IV. Decision

A. Majority Opinion

In holding that the SEC's hiring process for ALJs violated the Appointments Clause, the court relied on *Freytag* and concluded that ALJs are "inferior officers" and as such, they must be appointed by the President, a court of law, or a department head.[92] The court expressly rejected the *Lucia* court's determination that whether an ALJ possesses final decision-making authority is dispositive for determining inferior officer status, and instead focused on *Freytag*'s three-prong test.[93] Applying the *Freytag* test, the court looked to (1) whether the position was established by law; (2) whether the duties, salary, and means of appointment are delineated in a statute; and (3) the amount of discretion exercised in carrying out important functions that are "more than ministerial tasks."[94]

First, the SEC ALJ position was "established by law," in the APA.[95] Second, SEC ALJs' duties, salary, and means of appointment are governed by statute.[96] Third, the SEC ALJs exercise significant discretion in carrying out "important functions," including "ruling on the admissibility of evidence, ruling on dispositive and procedural motions," taking testimony, "issuing subpoenas, and presiding over trial-like hearings," which "the SEC affords 'considerable weight' during agency review."[97] The court rejected the *Lucia* court's focus on final decision-making power, holding that while "[f]inal decision-making power is relevant in determining whether a public servant exercises significant authority . . . that does not mean *every* inferior officer *must* possess final decision-making power."[98] Finding that "SEC ALJs closely resemble the STJs described in *Freytag*," the Tenth Circuit held SEC ALJs are inferior officers and thus must be appointed in accordance with the Appointments Clause.[99]

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92. *Id.* at 1179.
93. *Id.* at 1179-85.
94. *Id.* at 1179, 1181 (quoting Freytag v. Comm'r, 501 U.S. 868, 881-82 (1991)).
95. *Id.* at 1179 (quoting U.S. Const. art. II, § 2, cl. 2).
96. *Id.*
97. *Id.* at 1179-80 (quoting Bandimere, SEC Release No. 9972, Securities Act Release No. 76308, Exchange Act Release No.33-9972, 2015 WL 6575665, at *15 n.83 (Oct. 29, 2015)).
98. *Id.* at 1183-84.
99. *Id.* at 1181.

B. Concurring Opinion

In a concurring opinion, Judge Mary Beck Briscoe refuted the dissent's assertion that the majority's ruling potentially invalidates all ALJs and not simply SEC ALJs.[100] Judge Briscoe argued that even if the majority decision potentially invalidated appointment of all current ALJs, the long-term effects would be minor because courts generally seek "the *minimum* relief necessary to bring administrative overreach in line with the Constitution."[101] Judge Briscoe also criticized the dissent's reliance on *Landry* and *Lucia*, asserting that although "final decision-making power might be *sufficient* to make an employee an officer, that does not mean that such authority is *necessary"* to make an employee an officer.[102] Instead, she argued that the court should examine all the "duties and functions" that the ALJ has been delegated "to determine whether that person is exercising the authority of the United States" and is therefore an officer.[103]

C. Dissenting Opinion

In his dissent, Judge Monroe McKay pointed out that the consequences of the *Bandimere* decision extended far beyond the SEC and its five ALJs. Judge McKay noted that "under the majority's interpretation of *Freytag*, all federal ALJs are at risk of being declared inferior officers . . . effectively render[ing] invalid thousands of administrative actions."[104] In response to Judge McKay's concerns, Judge Briscoe, writing for the concurrence, noted that *Freytag* requires courts to "engage in a case-by-case analysis" of the status of government employees, and that the *Bandimere* decision was limited to the SEC's five ALJs.[105]

McKay also argued that "*Freytag*, which was decided twenty-five years ago, should not apply because it has never before been extended by a circuit court to any ALJ."[106] McKay asserted that the majority was incorrect in concluding that the STJs of the tax court in *Freytag* were analogous to the SEC's ALJs.[107] "[T]he [STJs] at issue in *Freytag* had the . . . power to bind the Government and third parties" while "SEC ALJs do not."[108] He

100. *Id.* at 1189 (Briscoe, J., concurring).
101. *Id.* at 1190.
102. *Id.* at 1192.
103. *Id.* at 1191.
104. *Id.* at 1199 (McKay, J., dissenting).
105. *Id.* at 1188-89 (Briscoe, J., concurring).
106. *Id.* at 1201 (McKay, J., dissenting).
107. *Id.* at 1194.
108. *Id.*

contended that the SEC ALJs lack of "final decision-making authority" should be determinative, and "under the Appointments Clause, that difference makes all the difference."[109]

D. Petition for Certiorari and ALJ Ratifications

Following *Bandimere*, the solicitor general and the SEC filed a short petition for certiorari, but noted that *Lucia* was a better vehicle to decide the issue.[110] When the *Lucia* petition for certiorari was first filed, many confidently predicted it would be granted.[111] However, the case took a surprising turn when the solicitor general filed a brief in support of certiorari, abruptly abandoning his defense of the SEC ALJ hiring scheme and accepting the petitioner's claim that the SEC's ALJs are in fact "inferior officers" subject to the Appointments Clause requirements.[112] Seemingly in response to these developments, and in an attempt to stave off Supreme Court review, the SEC issued an order ("Ratification Order") ratifying the appointment of the SEC's five ALJs to mitigate any concern that their decisions and operations violated the Appointments Clause.[113] While the SEC and the petitioners for certiorari now agree that SEC ALJs are "inferior officers" subject to the Appointments Clause, the Supreme Court was not bound by the solicitor general's and SEC's characterization. The issue was not moot because the Supreme Court ruling affects dozens of other federal agencies that also utilize ALJs.[114] Additionally, by ratifying the ALJ appointments, the SEC may have opened the door to other challenges regarding the restrictions on ALJs' removal because the SEC's ratification process addresses only the hiring, and not the firing, of ALJs.[115]

109. *Id.*

110. Petition for Writ of Certiorari, *Bandimere*, 844 F.3d 1168 (No. 17-475).

111. Jonathon H. Adler, *Is Lucia Still Cert-Worthy?*, VOLOKH CONSPIRACY (Jan. 2, 2018, 10:33 PM), http://reason.com/volokh/2018/01/02/is-lucia-still-cert-worthy ("When the *Lucia* cert petition was first filed, it seemed like an almost certain grant.").

112. Brief for Respondent at 9-22, Lucia v. SEC, 832 F.3d 277 (D.C. Cir. 2017) (No. 17-130), 2017 WL 5899983, at *9-22.

113. Pending Admin. Proceedings, SEC Release No. 4816, Securities Act Release No. 10440, Exchange Act Release No. 32929, Investment Company Act Release No. IC-32929, 2017 WL 5969234, at *1 (Nov. 30, 2017).

114. *See* Reply Brief for Petitioners at 5-6, *Lucia*, 832 F.3d 277 (No. 17-130), 2017 WL 6383147, at *5-6.

115. *See id.*

V. Analysis

A. The Tenth Circuit Correctly Applied the Freytag Analysis

The Tenth Circuit explained that the D.C. Circuit's decisions in *Landry* and *Lucia* incorrectly applied *Freytag*'s framework because "[final-decision-making authority] was not dispositive to *Freytag*'s holding."[116] The Supreme Court in *Lucia* also found *Freytag* determinative.[117] In *Freytag*, the Court expressly rejected the contention that lack of power to make final decisions takes officials outside the Appointments Clause.[118] Under *Freytag*, only duties, authority, and power determine whether significant discretion is exhibited; decision-making authority is sufficient, but not necessary, to find that an official is an officer.[119] "Although ALJs can be distinguished from STJs in many ways, the principle similarities they do share are the ones that consider them inferior officers."[120] SEC ALJs have statutory roots and "exercise the same 'significant discretion' when carrying out the same 'important functions' as STJs do," such as taking testimony, conducting trials, ruling on evidentiary issues and enforcing discovery orders.[121] Moreover, an ALJ initial decision, unlike STJ findings or opinions, can become final without being reviewed by the Commission.[122] Not only do SEC ALJs exercise significant authority, making them "inferior officers," but their current appointment scheme deprives the people of any ability to hold the appointed official accountable for the consequential actions of the SEC ALJs.

B. The Concern That Bandimere *Will Have a Wide-Sweeping Harmful Effect Is Unwarranted and Exaggerated*

1. Holding That ALJs Are "Inferior Officers" Will Not Call into Question the Constitutionality of All Prior Decisions Rendered by ALJs

The SEC issued the Ratification Order ratifying the appointment of the SEC's five ALJs with the intent to "resolve[] any concerns" regarding any

116. SEC v. Bandimere, 844 F.3d 1168, 1182-85 & n.36 (10th Cir. 2016).

117. *See* Lucia v. SEC, 138 S. Ct. 2044, 2047 (2018).

118. *See* Freytag v. Comm'r, 501 U.S. 868, 881-82 (1991).

119. *Id.*

120. Thomas C. Rossidis, *Article II Complications Surrounding SEC-Employed Administrative Law Judges*, 90 ST. JOHN'S L. REV. 773, 805 (2016).

121. *Lucia*, 138 S. Ct. at 2048 (quoting *Freytag*, 501 U.S. at 881-82). 138 S.Ct. 2044, 2055 ple, the Social Security Administration,remedy, the actual effect on other agencies is less clear. e Appoin

122. *Id.*

potential Appointments Clause weakness.[123] However, whether this order actually cures any impending constitutional issues depends on the stage of a case in the administrative process. The SEC's move to ratify the appointment of its ALJs has a different effect depending on whether the case is closed, pending, or not yet brought.

The Ratification Order is silent on what is to be done in closed cases and cases currently on appeal to a federal court.[124] These cases have already resulted in an initial decision and a Commission order affirming that decision; this silence fails to resolve the uncertainty surrounding those decisions.[125] Because SEC ALJs are "inferior officers," there is uncertainty whether parties in closed cases could claim that their constitutional rights were violated by improperly-appointed ALJs and subsequently sue for damages based on the Supreme Court's decision in *Lucia*. This list of potential claimants would include those who had previously paid penalties or were banned from the industry.[126] Nonetheless, any ALJ decisions for which appeals have been denied or time to appeal has expired would likely be considered final and binding decisions.[127] "Final administrative decisions would not be subject to [collateral] attack . . . even when an adjudicator lacks the power to decide a case [due to] the presumption in favor of finality."[128] The Supreme Court has made this presumption clear by holding that even when the judge lacked the authority to preside over a case, the defect cannot be attacked collaterally once a judgment has become final.[129]

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123. Press Release, SEC, SEC Ratifies Appointment of Administrative Law Judges (Nov. 30, 2017), https://www.sec.gov/news/press-release/2017-215.

124. *See id.*

125. *See id.* There are currently around a dozen cases on appeal from the SEC in the federal courts. *Lucia v. SEC*, BALLOTPEDIA, https://ballotpedia.org/Lucia_v._SEC (last visited Sept. 22, 2018).

126. N. Peter Rasmussen, *Messy Clouds and Inferior Officers—The SEC, ALJs and Order Maintained*, BNA: CORP. TRANSACTIONS BLOG (Dec. 1, 2017), https://www.bna.com/messy-clouds-inferior-b73014472686/.

127. *See* 15 U.S.C. § 78y(a) (2012).

128. Griffin, *supra* note 17, at 229.

129. *See* Travelers Indem. Co. v. Bailey, 557 U.S. 137, 154 (2009) (noting that res judicata and practical necessity prevent collateral attacks on jurisdiction on final orders); Peter D. Hardy, Carolyn H. Kendall & Abraham J. Rein, *The Appointment of SEC Administrative Law Judges: Constitutional Questions and Consequences for Enforcement Actions* (June 22, 2015), http://www.postschell.com/site/files/post__schell__bloomberg_bna__sec_alj_constitutional_questions__6_19_15.pdf (reprint of article from 47 Sec. Reg. & L. Rep. (BNA) 1238); Alison Frankel, *Unlike SEC, FTC Makes Quick Fix to Ward of ALJ Constitutional Challenges*, REUTERS: BLOGS (Sept. 16, 2015), http://blogs.reuters.com/

Thus, it is likely that parties with final administrative determinations will be unable to successfully attack those rulings collaterally on the grounds that the ALJs were appointed unconstitutionally.

The Ratification Order explicitly addressed cases pending before the ALJ or the Commission.[130] The Order directed that, in all proceedings currently pending before an ALJ or the Commission, the same ALJ who conducted the proceedings in the first instance must reconsider the entire record, allow the parties to submit new evidence, re-examine all prior judicial rulings, and issue an order regarding the same.[131] However, the *Lucia* Court held that a *different* ALJ must conduct the new proceeding.[132] More than one hundred pending cases must be reconsidered pursuant to the Supreme Court's holding.[133]

The Ratification Order also addresses the constitutionality of any future ALJ decisions.[134] As long as the judge has been properly appointed, no future administrative proceedings before an SEC ALJ will have a claim on appeal for vacatur of a decision based on the Appointments Clause.[135] However, Lucia argued that the Ratification Order is not a constitutionally permissible way to appoint an Officer and "has no effect on any other case."[136] The Lucia Court did not address whether additional remedial action by the Commission is necessary.[137] However, the Commission, as the head of department, has the power to appoint ALJs and did so by ratification.[138] The Restatement (Third) of Agency specifies that "[r]atification is the affirmance of a prior act done by another, whereby the act is given effect as if done by an agent acting with actual authority."[139] In other words, there must first be an unauthorized act in order for it to be

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alison-frankel/2015/09/16/unlike-sec-ftc-makes-quick-fix-to-ward-off-alj-constitutional-challenges/.

130. Pending Admin. Proceedings, SEC Release No. 4816, Securities Act Release No. 10440, Exchange Act Release No. 32929, Investment Company Act Release No. IC-32929, 2017 WL 5969234, at *1 (Nov. 30, 2017).

131. *Id.*

132. Lucia v. SEC, 138 S. Ct. 2044, 2055 (2018).

133. *See* Pending Admin. Proceedings, at *3 (listing proceedings remanded to ALJs).

134. *See id.* at *1.

135. Press Release, *supra* note 123; Heidi VonderHeide, *SEC Decrees That Its ALJs Are Constitutional. Now What?*, LEXOLOGY (Nov. 30, 2017), https://www.lexology.com/library/detail.aspx?g=bcfe3890-dee9-41ef-a9b6-2b91fd392203.

136. Reply Brief for Petitioners, *supra* note 114 at 8.

137. *See Lucia*, 138 S. Ct. at 2055.

138. U.S. CONST., art. II, § 2, cl. 2.

139. RESTATEMENT (THIRD) OF AGENCY § 4.01(1) (AM. LAW INST. 2006).

ratified and given retroactive effect. However, Lucia also argued that the Commission's lack of involvement in hiring (not appointing) its ALJs means there was no prior appointment to be ratified.[140] In Lucia's view, the Commission cannot ratify an unconstitutional act.[141]

Lucia's argument mischaracterizes a cornerstone principle of agency law. A principal's "ratification retroactively creates the effects of actual authority," as long as it manifests its consent to the action being ratified.[142] By stating that it was "ratif[ying] the agency's prior appointment" of its five ALJs, the Commission clearly manifests consent to and approval of the prior appointments of its ALJs.[143] Adopting Lucia's understanding "would turn concepts of agency law on their head by requiring the principal to have been involved in the decision to be ratified."[144] The doctrine of ratification would be pointless if principals could ratify decisions only where they had initial involvement.[145] The SEC asserts that "it is apparent that the Appointments Clause does not bar Congress from limiting the pool of prospective appointees from which the Commission may appoint its [ALJs] and does not require the Commissioners to play any part in the selection of the [ALJs], other than the actual appointing."[146]

2. Holding That SEC ALJs Are "Inferior Officers" Does Not Spell the End of Enforcement Actions by ALJs Across the Entire Administrative System

Some are concerned that holding that SEC ALJs are officers could spell the end of enforcement actions by ALJs across the entire administrative system.[147] This concern is exaggerated. As an initial matter, agencies can avoid this issue by ratifying the appointment of its ALJs. However, if ratification is not a constitutionally permissible remedy, the actual effect on other agencies is less clear.

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140. *See* Reply Brief for Petitioners, *supra* note 114, at 8.

141. *Id.*

142. RESTATEMENT (THIRD) OF AGENCY §§ 4.01, 4.02.

143. Pending Admin. Proceedings, SEC Release No. 4816, Securities Act Release No. 10440, Exchange Act Release No. 32929, Investment Company Act Release No. IC-32929, 2017 WL 5969234, at *1 (Nov. 30, 2017).

144. *See* Order Denying Motion for Stay, David Pruitt, CPA, Administrative Proceedings Rulings Release No. 5603, at 5 n.27 (Feb. 15, 2018).

145. *Id.*

146. *Id.* at 7.

147. *See* SEC v. Bandimere, 844 F.3d 1168, 1199 (10th Cir. 2016) (McKay, J., dissenting).

Additionally, many agencies, including, for example, the Social Security Administration ("SSA"), might not be affected because they are distinguishable from the SEC ALJs and the *Freytag* STJs.[148] The SSA employs 1655 ALJs, which is a vast majority of all the federal ALJs.[149] Judge McKay commented in his dissent that he "cannot discern a meaningful difference between SEC ALJs and [Social Security Administration] ALJs under the majority's reading of *Freytag*."[150] The dissent's concern is overblown because whether those ALJs are also "inferior officers" turns on the scope of their individual functions and discretion.[151] The *Freytag* analysis proceeds case-by-case, and this case deals only with the duties and qualities of a particular set of five SEC ALJs, and not, for example, with the different characteristics of the SSA ALJs who make up the bulk of all federal ALJs.[152] Therefore, the only way the Supreme Court could resolve SSA ALJ status is if the Court adopted the reasoning in *Lucia*, focusing solely on final decision-making power.[153] However, even under the *Freytag* analysis the SSA ALJs would likely not be considered "inferior officers."[154]

Although SEC ALJs and SSA ALJs might share some of the same duties, there are unique distinctions potentially relevant to their analysis under the Appointments Clause. For example, SSA ALJs wear the hats of both a judge and an agency attorney with the duty of examining witnesses and developing the record to ensure that only deserving claimants get paid.[155] They do not conduct adversarial hearings similar to those conducted by an SEC ALJ trial determining alleged securities violations.[156] In *Lucia*, on rehearing en banc, Petitioner's attorneys argued that finding that the

148. *See* Lucia v. SEC, 138 S. Ct. 2044, 2058 (2018) (Breyer, J., dissenting).

149. *Administrative Law Judges: ALJs by Agency*, U.S. OFF. OF PERSONNEL MGMT., https://www.opm.gov/services-for-agencies/administrative-law-judges/#url=ALJs-by-Agency (last updated March 2017).

150. *Bandimere*, 844 F.3d at 1200 (McKay, J., dissenting).

151. Brief of the Chamber of Commerce of the United States as Amicus Curiae Supporting Petitioners at 19, Lucia v. SEC, 832 F.3d 277 (D.C. Cir. 2017) (en banc) (No. 15-1345), 2017 WL 947745.

152. *Bandimere*, 844 F.3d at 1188-89 (Briscoe J., concurring).

153. *See Lucia*, 832 F.3d at 286.

154. *See* Freytag v. Comm'r, 501 U.S. 868, 881-82 (1991).

155. *See* Sims v. Apfel, 530 U.S. 103, 111 (2000) ("It is the ALJ's duty to investigate the facts and develop the arguments both for and against granting benefits . . . .").

156. Frank S. Bloch, Jeffrey S. Lubbers & Paul R. Verkuil, *Developing a Full and Fair Evidentiary Record in a Nonadversary Setting: Two Proposals For Improving Social Security Disability Adjudications*, 25 CARDOZO L. REV. 1, 3 (2003).

SEC ALJs were unconstitutionally appointed would not affect the thousands of ALJs employed by the SSA because the fact "that those judges are engaged in the doling out of government largess rather than executing enforcement powers on behalf of the president, makes all the difference."[157]

Even if other agency ALJ appointment schemes violate the Constitution, agencies that have amended their ALJ appointment process in the past have shown that they are unlikely to experience any significant disruption.[158] Although there may be some minor inconvenience because SEC ALJs were found to be "inferior officers," constitutional requirements should not yield to convenience and expediency.[159] "Certainly the possibility of additional violations of the Constitution does not justify turning a blind eye to the Constitution's requirements."[160]

VI. Conclusion

SEC ALJs wield incredible power that can impact individuals as well as the financial industry as a whole. The considerable increase in power SEC ALJs attained post Dodd-Frank, combined with their many quasi-judicial duties, indicates that SEC ALJs no longer act as mere "employees." The court's decision in *Bandimere* correctly determined that SEC ALJs are "inferior officers" and must be appointed in accordance with the Appointments Clause. This decision determined that SEC ALJs are officers by applying the analysis developed in *Freytag*, notwithstanding that SEC ALJs do not have final decision-making authority.

Classifying SEC ALJs as officers promotes the purpose of the Appointments Clause—to ensure that those who wield appointment power are accountable to political force and the will of the American people.[161] The concern that holding SEC ALJs are officers will have a far-reaching undesirable result is unwarranted. It will not render past decisions invalid

157. Oral Argument at 19:30, Lucia v. SEC, *on reh'g en banc*, 868 F.3d 1021 (D.C. Cir. 2017), https://www.cadc.uscourts.gov/recordings/recordings2017.nsf/B5D9C12F894EF5D58525812A005C2AB5/$file/15-1345.mp3.

158. *See, e.g.*, Act of Aug. 12, 2008, Pub. L. 110-313, § 1, 122 Stat. 3014, 3014 (amending the method of appointing administrative patent and trademark judges to be by the Secretary of Commerce); *In re* LabMD, Inc., No. 9357, 2015 WL 5608167, at *2 (F.T.C. Sept. 14, 2015) (noting reappointment of FTC administrative law judge).

159. *See* Bowsher v. Synar, 478 U.S. 714, 736 (1986) (citing INS v. Chadha, 462 U.S. 919, 944 (1983)).

160. Brief of the Chamber of Commerce of the United States as Amicus Curiae Supporting Petitioners, *supra* note 146, at 19.

161. Freytag v. Comm'r, 501 U.S. 868, 884 (1991).

because the presumption in favor of finality prevents them from being attacked collaterally. Further, the concern is exaggerated because this holding does not spell the end of enforcement actions by ALJs across the entire administrative system. The *Freytag* analysis is employed on a case-by-case basis, and each set of agency ALJs will be considered individually to determine if the judges in question have the level of authority that would earn them inferior officer status. The holding causes a slight inconvenience to the administrative system, but convenience and efficiency are not the primary objectives of our government. Rather, the protection of liberty is chief among our government's goals. Requiring the appointment of SEC ALJs to comport with the Appointments Clause secures the liberty of the American people by assuring the appropriate elected official is accountable for agency decision-making.

Abbey Zuech