

D.C. Circuit Court Holds That the SEC's Administrative Courts Are Constitutional

On August 9, 2016, the United States Court of Appeals for the District of Columbia Circuit affirmed the constitutionality of the administrative forum increasingly used by the Securities and Exchange Commission (“SEC”) to adjudicate SEC enforcement actions. In *Raymond J. Lucia Cos., Inc. v. SEC*, the D.C. Circuit became the first federal circuit court to hold that the Administrative Law Judges (“ALJs”) who preside over SEC administrative actions do so in compliance with the requirements of the United States Constitution.¹ While the decision represents the views of only one appellate court, and does not preclude a contrary decision from any court outside the D.C. Circuit, it nonetheless serves as a bellwether for similar disputes currently working their way through other federal and administrative courts.

I. Background

Section 4A of the Securities Exchange Act of 1934 (the “Exchange Act”) authorizes the SEC to delegate its functions to “a division of the Commission, an individual Commissioner, [or] an administrative law judge,” among other individuals and groups.² Pursuant to this section the SEC has delegated to ALJs the authority to conduct administrative hearings and to make initial decisions in certain SEC proceedings.³ At the outset of an SEC enforcement action the SEC has discretion to submit its case to an ALJ for decision, or instead, like private litigants, to file its case in federal district court.

In some important respects, an ALJ’s authority mirrors that granted to federal district court judges, including the authority to administer oaths, rule on offers of proof and motions filed by parties, examine witnesses, enter orders of default, and punish contemptuous conduct. Unlike district court actions, however, there is no right to a jury trial in SEC administrative proceedings, and administrative proceedings allow for only abbreviated pretrial practice (with significant limitations imposed on fact discovery and motion practice), resulting in a much less developed factual record than that typically produced through the federal court discovery process. And the ALJ decisions that result from SEC administrative proceedings are subject to review by the Commission, while federal district court decisions are not. The SEC believes administrative proceedings to be beneficial in that they offer the SEC a mechanism to adjudicate enforcement actions comparable to the process afforded in federal district court, without the delay and expenditure of SEC resources that protracted federal court litigation can entail.

Raymond J. Lucia Cos., Inc. v. SEC arose from an action by the SEC against Raymond J. Lucia and Raymond J. Lucia Companies, Inc. for violations of the anti-fraud provisions of the Investment Advisers Act of 1940 and related SEC rules. The SEC filed the case as an administrative action instead of filing in federal court.⁴ The presiding ALJ issued an initial decision finding respondents liable for making misrepresentations in their presentations to prospective investors concerning the investment strategy respondents were promoting. Exercising its statutory authority to review ALJ decisions, the Commission remanded the case for further findings of fact, which ultimately resulted in a revised initial decision by the ALJ. Both the SEC and the respondents sought Commission review of the revised initial decision.

¹ No. 15-1345, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016).

² 15 U.S.C. § 78d-1.

³ 17 C.F.R. § 200.30-9.

⁴ See *In re Raymond J. Lucia Companies, Inc.*, Exchange Act Release No. 67781 (Sept. 5, 2012).

On review, the Commission affirmed the ALJ’s revised initial decision as it pertained to the SEC’s fraud charges. In addition, the Commission “rejected petitioners’ argument that the administrative proceeding was unconstitutional because the presiding ALJ was not appointed in accordance with the Appointments Clause under Article II, Section 2, Clause 2 of the Constitution.” Relying on an earlier decision from the Court of Appeals for the D.C. Circuit, “the Commission concluded its ALJs are employees, not Officers, and their appointment is [therefore] not covered by the” Constitution’s Appointments Clause.⁵

II. The Circuit Court’s Opinion

On appeal to the D.C. Circuit Court, Raymond J. Lucia and Raymond J. Lucia Companies argued, as they had before the Commission, that the Commission’s decision on the constitutional question should be vacated because “the ALJ rendering the initial decision was a constitutional Officer who was not appointed pursuant to the Appointments Clause” of the Constitution.⁶ The Commission conceded that the ALJ presiding in the underlying action was not appointed according to the process set out in the Appointments Clause, which requires the President, with the advice and consent of the Senate, to appoint “Officers of the United States, whose Appointments are not . . . otherwise provided for” in the Constitution.⁷ Nor did the parties dispute that the Appointments Clause has been interpreted to apply to judicial officers and officers of administrative agencies such as the SEC.

Instead, the D.C. Circuit Court’s decision turned on the scope of an ALJ’s authority to resolve SEC enforcement disputes. Citing the Supreme Court’s decision in *Buckley v. Valeo*, the court observed that “generally an appointee is an Officer, and not an employee who falls beyond the reach of the [Appointments] Clause, if the appointee exercises ‘significant authority pursuant to the laws of the United States.’”⁸ In turn, whether government officials exercise “significant authority” is determined by three factors: “(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.”⁹ The principal issue before the D.C. Circuit Court in *Raymond J. Lucia Cos.* concerned the third factor—“whether Commission ALJs issue final decisions of the Commission.”¹⁰

After analyzing the statutory scheme governing the Commission’s process for reviewing ALJ decisions, the court determined that ALJs do not have authority to issue final Commission decisions, and so are not “Officers” within the meaning of the term contemplated by the Appointments Clause:

There can be no serious question that [the Exchange Act] reserves to the Commission a discretionary right to review the action of any ALJ as it sees fit.¹¹ * * * [T]he Commission’s ALJs neither have been delegated sovereign authority to act independently of the Commission nor, by other means established by Congress, do they have the power to bind third parties, or the government itself, for the public benefit. . . . The Commission’s right of discretionary review under [the Exchange Act] and adoption of its regulatory scheme for delegation . . . ensure that the

⁵ *Raymond J. Lucia Cos., Inc.*, 2016 WL 4191191 at *3.

⁶ *Id.*

⁷ U.S. Const. art. II, § 2, cl. 2.

⁸ *Raymond J. Lucia Cos., Inc.*, 2016 WL 4191191 at *3 (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976)).

⁹ *Id.* at *4.

¹⁰ *Id.*

¹¹ *Id.* (internal quotations omitted).

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politically accountable Commissioners have determined that an ALJ’s initial decision is to be the final action of the Commission.¹²

Because of this statutory check on their decision-making authority, the court deemed ALJs to be employees of the Commission and, therefore, “beyond the reach” of the Constitution’s Appointments Clause. In short, the court held that the SEC’s administrative law courts are constitutional.

III. Conclusion

Because the jurisdiction of the D.C. Circuit Court is limited, the impact of the court’s decision in *Raymond J. Lucia Cos.* will necessarily be circumscribed. The constitutionality of the SEC’s administrative courts remains an open issue, one which is currently being litigated in other federal courts and which is preserved for appellate review in a number of pending SEC administrative actions. The decision likely represents only the first of several appellate court decisions, and any inter-circuit disagreement that results can only be resolved when, and if, the U.S. Supreme Court takes up the constitutional issue that *Raymond J. Lucia Cos.* addresses.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or David S. Slovick at 212.701.3978 or dslovick@cahill.com.

¹² *Id.* at *5.