

# Client Alert

July 2018

## Supreme Court Boots SEC ALJ in *Lucia v. SEC*: Could This Decision Fuel the Constitutional Questions Surrounding the CFPB?

On June 21, 2018, the Supreme Court of the United States remanded to the Securities and Exchange Commission (SEC) an administrative proceeding against Raymond Lucia to be tried by a different administrative law judge (ALJ) because the original ALJ who issued the initial decision against Lucia was improperly appointed.<sup>1</sup> In the wake of constitutional questions involving the Consumer Financial Protection Bureau (CFPB), the *Lucia* decision could affect more than just the SEC.

The SEC charged Raymond Lucia under the Investment Advisers Act for using misleading slideshow presentations to deceive prospective clients. The SEC assigned ALJ Cameron Elliot to adjudicate the case. In the initial decision, Elliot concluded that Lucia violated the act and imposed sanctions, including civil penalties of \$300,000 and a lifetime bar from the investment industry. On appeal to the SEC, Lucia argued that the administrative proceeding was invalid because ALJ Elliot was not properly appointed pursuant to the requirements of the Appointments Clause of the Constitution.<sup>2</sup> The SEC rejected Lucia's argument, stating that SEC ALJs are mere employees—not "Officers of the United States"—and, therefore, fall outside the Appointments Clause's ambit. The Court of Appeals for the DC Circuit upheld the SEC's determination, and Lucia filed a petition with the Supreme Court. Notably, once this matter reached the Supreme Court, the Department of Justice, which had up until that point defended the SEC's position, switched sides. Therefore, the Court appointed amicus curiae to defend the lower court's judgment.

In reversing the lower court, the Supreme Court explained that the Appointments Clause prescribes the exclusive means of appointing "Officers."<sup>3</sup> Specifically, only the president, a court of law or a head of department can do so. The Supreme Court noted that none of these actors appointed the SEC ALJ who heard Lucia's case; instead, SEC staff members gave the ALJ his position. The Supreme Court then turned to the question of whether the SEC's ALJs are "Officers of the United States" or simply employees of the federal government.<sup>4</sup>

The Supreme Court used the analyses from *Freytag v. Commissioner*,<sup>5</sup> where the Court determined that "special trial judges" (STJs) of the United States Tax Court are officers because they: (1) hold a continuing office established by law; (2) hold significant responsibilities, including taking testimony, conducting trials, ruling on the admissibility of evidence and having the power to enforce compliance with discovery orders; and (3) may exercise significant discretion. The Supreme Court determined that, like Tax Court STJs in *Freytag*, SEC ALJs hold a continuing office established by law and exercise significant

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<sup>1</sup> *Lucia v. S.E.C.*, No. 17-130, 2018 WL 3057893 (U.S. June 21, 2018).

<sup>2</sup> Art. II, §2, cl. 2.

<sup>3</sup> *Lucia*, No. 17-130, 2018 WL 3057893 at \*3.

<sup>4</sup> *Id.* at \*5.

<sup>5</sup> 501 U.S. 868 (1991).

discretion when carrying out the same important functions. The Supreme Court stated that SEC ALJs could also play a more autonomous role, because the SEC can decide against reviewing an ALJ decision, in which case the ALJ's decision becomes final and is deemed the action of the SEC. The Supreme Court determined that the SEC's ALJs are "Officers of the United States," subject to the Appointments Clause and ALJ Elliot was not properly appointed. To cure the constitutional error, the Supreme Court stated that another ALJ (or the SEC itself) must hold a new hearing for Lucia.<sup>6</sup>

The Supreme Court's decision depended upon the particular facts and circumstances of this administrative proceeding. However, the holding may affect appointments of other "inferior officers" in other federal agencies depending on the particular ALJ appointment, hiring process and applicable governing statutes. For example, the Court's ruling may impact the ALJs at the CFPB with a similar structure; decisions issued by ALJs who were in the SEC system but deciding cases for the CFPB; and the pending matter addressing the appointment of the acting director of the CFPB in *English v. Trump*.

Recently, the various structures and operations of the CFPB are being questioned by cases such as *English v. Trump* and *PHH Corporation v. Consumer Financial Protection Bureau*.<sup>7</sup> Over the past year, Hunton & Williams LLP (now Hunton Andrews Kurth LLP) has released articles discussing the reform efforts related to the CFPB.<sup>8</sup> Currently, CFPB ALJs are appointed for life under the Administrative Procedure Act<sup>9</sup> through a procedure administered by the Office of Personnel Management. However, similar to SEC ALJs, CFPB ALJs administer formal proceedings and release opinions that go to the CFPB director. Moreover, the ALJs have complete judicial independence from the CFPB. As courts continue to analyze the constitutionality of the appointment of Acting Director Mulvaney and the CFPB's exercise of executive power, the *Lucia* decision may lead to CFPB ALJ scrutiny.

We will continue to follow these issues and keep you updated.

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<sup>6</sup> *Lucia*, No. 17-130, 2018 WL 3057893 at \*8.

<sup>7</sup> *PHH Corporation v. Consumer Financial Protection Bureau*, 839 F. 3d 1 (D.C. Cir. 2016), rehearing en banc granted, order vacated (D.C. Cir. 2017), reversed en banc, 881 F.3d 75 (Jan. 31, 2018).

<sup>8</sup> See <https://www.hunton.com/en/insights/dodd-frank-reform-alerts.html> for the series of articles related to this topic.

<sup>9</sup> 5 U.S.C. § 500 et seq.