

SEC Proceedings Face Uncertainty After Supreme Court Holds ALJs Unconstitutional

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After much anticipation, the U.S. Supreme Court ruled on the constitutionality of the Securities and Exchange Commission's (SEC or Commission) Administrative Law Judges (ALJs). In *Lucia v. SEC*, Dkt. No. 17-130, the Supreme Court held that ALJs are "Officers of the United States" subject to the Appointments Clause of the U.S. Constitution, rather than mere federal employees. The Appointments Clause provides that such officers must be appointed by the President, a head of department, or a court of law, whereas the SEC's ALJs historically have been hired by the SEC staff.

The Court's decision calls into question the validity of SEC administrative proceedings held before ALJs — a process by which many SEC enforcement actions are decided — and leaves unanswered other important questions.

The Supreme Court considered that the question of whether SEC ALJs are officers rather than federal employees depended on whether the ALJs "exercise significant authority pursuant to the laws of the United States." The Supreme Court found its answer in *Frytag v. Commissioner*, 501 U.S. 869 (1991), which held that "special trial judges" of the IRS (STJs) were officers because they exercised significant authority to "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders." Reasoning that SEC ALJs are "near-carbon copies" of the STJs, the Court found that SEC ALJs similarly exercise such "significant authority."

Accordingly, the Court held that the ALJ who presided over the *Lucia* administrative proceeding was an unconstitutionally appointed officer, and that respondents in the proceeding were entitled to a new hearing before a constitutionally appointed ALJ who was not the same individual who presided previously.

The *Lucia* decision may have no significant effect on completed administrative proceedings because the Court emphasized that respondents’ “timely challenge” entitled them to the relief sought, implying that parties who did not timely challenge the SEC on similar grounds, or who otherwise settled with the SEC, will be unable to raise such arguments now.

In contrast, the Court’s decision will surely impact the dozens of administrative proceedings currently pending before SEC ALJs, as well as future proceedings. In an August 23 order (Order), the SEC lifted a stay it had placed on all pending proceedings following the *Lucia* decision, and directed that every such case be reheard by an ALJ that — unless the parties agree otherwise — had not previously participated in the matter.

In addition to likely causing major delays, rehearing all these cases from the beginning may allow respondents to make challenges or arguments that they did not previously raise.

The *Lucia* decision may also play a significant role in future administrative proceedings. The Order reiterated the Commission’s 2017 ratification of the appointments of its five ALJs who had been hearing cases prior to *Lucia*. The Court, however, specifically declined to address whether the SEC’s ratification constituted a constitutional appointment. We can expect, therefore, that some respondents will challenge the ratification process as an invalid appointment. We will stay tuned to see how the SEC and the courts handle such challenges.

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