

## CLIENT ALERT

### 10th Circuit Decision Holds That the SEC's Method for Appointing Administrative Law Judges Violates the Appointments Clause of the U.S. Constitution

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On December 27, 2016, in *Bandimere v. SEC* (No. 15-9586), a three-judge panel (Matheson, Briscoe (concurring), and McKay (dissenting)) of the U.S. Court of Appeals for the 10th Circuit set aside an enforcement order of the United States Securities and Exchange Commission (SEC), holding that the initial decision on which the SEC order was based had been issued by a SEC administrative law judge (ALJ) who had been unconstitutionally named to his position. The potential implications of the court's decision, not only to the SEC but to the vast array of federal regulatory programs that utilize ALJs, are substantial.

The Court's decision is based on its determination that SEC ALJs are "inferior officers" of the United States as that term has come to be defined through decisions of the Supreme Court. The seminal modern case on "inferior officers" is *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868 (1991), but Supreme Court cases dating back to 1839 have held particular federal positions to be "inferior offices." The *Freytag* case and others distinguish between (1) "Officers of the United States," who must be appointed by the President pursuant to the Appointments Clause, U.S. Const. art. II, § 2, cl. 2, (2) federal "employees" who are not subject to the Appointments Clause and thus may be appointed directly by the agencies, and (3) "inferior officers" who, although not "Officers of the United States," have sufficiently independent decision-making authority and responsibility to make them subject to the Appointments Clause.

The 10th Circuit held that the all five of the SEC ALJs (not just the one who wrote the initial decision in the *Bandimere* case) were "inferior officers," not "employees," of the SEC, and therefore held their offices "in violation of the Appointments Clause" since they had not been appointed by the President, a court, or a department head. As a result, the Court held, the SEC's enforcement order was vacated.

There are many thousands of ALJs in the federal system. While their scope of authority varies depending on the underlying statutory framework, all serve the common function and objective of conducting the initial stages of administrative adjudications (including, in the case of the SEC, supervising the discovery process, examining witnesses, ordering and regulating depositions and document production, regulating the course of the hearing, etc.), and of recommending proposed findings of fact and conclusions of law to the agency they serve (or, in the case of independent adjudicatory agencies, such as the Occupational or Mine Safety and Health Review Commissions, making findings and issuing decisions that are final in their own right unless reviewed by the respective commissions). In most instances, including at the SEC, the agency may accept, reject, modify or remand all or parts of an ALJ's proposed order; the agency head thus retains final decision-making authority, and does not delegate it to the ALJ.

But both the *Freytag* decision and the 10th Circuit's *Bandimere* order make clear that the agency head's retention of final decision-making authority cannot cure an unconstitutional appointment. Applying the *Freytag* test, the 10th Circuit found SEC ALJs to be "inferior officers" because (1) the office of the SEC ALJ was established by law; (2) the ALJs' duties, salaries and means

of appointment were also established by statute; and (3) the SEC ALJs exercise “significant discretion in performing ‘important functions’ commensurate with the [special trial judges] described in *Freytag*.” Slip op. at pages 18-19.

In dissent, Judge McKay notes that “today’s opinion carries repercussions that will throw out of balance the teeter-totter approach of determining which of all the federal officials are subject to the Appointments Clause,” dissenting op. at p. 1, and warns that “[u]nder the majority’s reading of *Freytag*, all federal ALJs are at risk of being declared inferior officers,” *id.* at p. 11. While both the majority and concurring opinions strive to limit the *Bandimere* holding to the SEC’s ALJs alone, they do not suggest how the underlying *Freytag* analysis, as construed by the *Bandimere* court, could lead to a different conclusion under other federal statutes, particularly since, as the majority notes, federal ALJs were created by the federal Administrative Procedure Act, a generic statute.

The *Bandimere* case arises during the last stages of the nation’s transition to the next administration, and presents both risks and opportunities for the new President. It is likely that a case with such large yet uncertain implications will ultimately be taken up by the Supreme Court. This is made more likely by the fact that, this past August, the D.C. Circuit reached a conflicting conclusion, holding that SEC ALJs are not inferior officers because their decisions are not final (i.e., their decisions are subject to review by the SEC itself). See *Raymond J. Lucia Cos., Inc. v. SEC*, 832 F.3d 277 (D.C. Cir. 2016). The 10th Circuit faulted the D.C. Circuit’s logic, pointing out that, under *Freytag*, whether an ALJ’s decision is “final” is not dispositive of whether the ALJ is an inferior officer. Nevertheless, the next Administration need not necessarily support the position taken by the SEC in the case. For the time being, we can expect that pending federal agency adjudications that are handled in the first instance by ALJs, particularly in the enforcement area, will be challenged by litigants, and similar arguments may well be raised both in future cases, and in challenges to previously decided disputes.

The following government agencies utilize ALJs:

- [Coast Guard](#)
- [Commodity Futures Trading Commission](#)
- [Department of Agriculture](#)
- [Department of Health and Human Services/Department Appeals Board](#)
- [Department of Health and Human Services/Office of Medicare Hearings and Appeals](#)
- [Department of Housing and Urban Development](#)
- Department of the Interior
- Department of Justice/Executive Office for Immigration Review
- [Department of Labor](#)
- Department of Transportation
- Department of Veterans Affairs
- Drug Enforcement Administration
- [Environmental Protection Agency](#)
- [Equal Employment Opportunity Commission](#)
- [Federal Aviation Administration](#)
- [Federal Communications Commission](#)

- Federal Energy Regulatory Commission
- [Federal Labor Relations Authority](#)
- [Federal Maritime Commission](#)
- [Federal Mine Safety and Health Review Commission](#)
- [Federal Trade Commission](#)
- Food and Drug Administration
- [International Trade Commission](#)
- Merit Systems Protection Board
- [National Labor Relations Board](#)
- National Transportation Safety Board
- [Nuclear Regulatory Commission](#)
- [Occupational Safety and Health Review Commission](#)
- [Office of Financial Institution Adjudication](#)
- [Patent and Trademark Office](#)
- [Postal Service](#)
- [Securities and Exchange Commission](#)
- Small Business Administration
- [Social Security Administration](#)

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