Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Government changes its mind: Lucia brief says SEC's law judges are officers, (Nov. 29, 2017)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

The government's long-awaited reply to Raymond J. Lucia's certiorari petition disputing the constitutionality of the SEC's administrative law judges stated that the government has changed its position in the case: the government now believes the better view is that the SEC's ALJs are inferior officers. Previously, the government and the SEC had argued in numerous cases that the SEC's ALJs are employees beyond the reach of the U.S. Constitution's Appointments Clause. The government also had previously told the justices that a case from the Tenth Circuit was a less suitable vehicle to mull the SEC's ALJs because of questions about whether Justice Gorsuch may have participated in that case while he was a nominee to the Supreme Court. According to the government, Lucia's case is the best vehicle for reviewing the status of the SEC's ALJs (*Lucia v. SEC*, November 29, 2017).

New government view. According to the government, review is warranted because the question of ALJs' status was left open by the Supreme Court in a footnote in the *Free Enterprise* case (upholding the Public Company Accounting Oversight Board's existence, but placing the board under closer presidential control) and because the Supreme Court's prior cases demonstrate that the SEC's ALJs exercise "significant authority." The government also said the ALJ question is "extremely important" because a decision may impact agencies beyond the SEC, a concern Justice Breyer raised in his dissent in *Free Enterprise*.

The government explained that the SEC's ALJs are similar to the Tax Court's special trial judges at issue in the Supreme Court's *Freytag* opinion. The D.C. Circuit in Lucia's case had relied on its *Landry* decision, which upheld the FDIC's ALJs on the ground that they did not exercise final authority, but the opinion drew a concurrence that suggested that the basis for the D.C. Circuit's decision (*Freytag*) also could be read to find that ALJs are inferior officers even if their decisions are not final.

The government also sought to refute various theories about *Freytag*. Specifically, the government said the finality of special trial judges and deference to them on credibility findings were not major factors in *Freytag*. In a footnote, the government also said the contempt authority of special trail judges (the SEC's ALJs have a similar, but lesser, authority according to the government) was cited to back the Supreme Court's finding that the Tax Court was a "Court of Law" for Appointments Clause purposes. The government also de-emphasized the Article I status of special trial judges.

Appointment and removal. The government noted that *Free Enterprise* held that multiple levels of for cause removal of officers can violate the constitution. With respect to the SEC, the government identified potentially three levels of tenure protection: (1) good cause removal by the Commission and Merit Systems Protection Board of ALJs; (2) removal of MSPB members for inefficiency or neglect of duty; and (3) tenure protection for SEC commissioners (the government said the Exchange Act is silent on this point, but *Free Enterprise* assumed they may have protections). The government urged the Supreme Court to grant certiorari in Lucia's case and either re-state the question presented or include another question regarding the removal issue.

The SEC's enforcement action. The SEC had brought an action against investment adviser Lucia alleging that aspects of his "Buckets of Money" investment strategy violated federal securities laws. The matter resulted in an initial decision that the adviser had made fraudulent misrepresentations, but on appeal the Commission asked

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the ALJ to do more factfinding. A revised initial decision made similar findings and a divided Commission mostly upheld the ALJ and the sanctions imposed.

Lucia then appealed to the D.C. Circuit, which initially held the SEC's ALJs are employees based on *Landry*. The appeals court eventually agreed to rehear Lucia's case after asking Lucia and the SEC to file briefs answering specific questions. The D.C. Circuit then denied the petition in a brief order stating the court was equally divided.

The case is No. 17-130.

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Companies: Raymond J. Lucia

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