

[Securities Regulation Daily Wrap Up, TOP STORY—D.C. Cir.: Judicial double header: full court to rehear Lucia and PHH, \(Feb. 16, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The full D.C. Circuit will rehear Raymond J. Lucia Companies, Inc.'s case challenging the constitutionality of the SEC's administrative law judges. The court vacated its earlier decision in the case and has asked the parties to brief the Appointments Clause issue and to address the validity of its *Landry* circuit precedent, which held that the FDIC's ALJs were employees, not inferior officers. The *Lucia* case also is now linked by [separate order](#) to PHH Corporation's constitutional challenge to the appointment of Richard Cordray to be director of the Consumer Financial Protection Bureau. The full court will rehear both *Lucia* and *PHH* on May 24 ([Raymond J. Lucia Companies, Inc. v. SEC](#), February 16, 2017, *per curiam*).

The upcoming rehearing. A unanimous D.C. Circuit panel held in [Lucia](#) that the SEC's ALJs were employees outside the scope of the Appointments Clause because they do not issue final decisions. That holding closely follows the rubric established by the court's prior decision in *Landry* regarding the non-finality of the FDIC's ALJs. But *Lucia* puts the D.C. Circuit at odds with the Tenth Circuit. In [Bandimere](#), a divided Tenth Circuit panel held that the SEC's ALJs are inferior officers subject to the Appointments Clause.

The full D.C. Circuit's decision in *Lucia* could strengthen or weaken this circuit split. Thus far, the Supreme Court has declined to hear challenges to the SEC's ALJs that involve jurisdictional questions. But *Lucia* and *Bandimere* are different because they came to the appellate courts on petitions for review of agency opinions and, thus, more directly present the constitutional issues the challengers want to eventually get before the justices. A circuit split is one of the most common arguments made in favor of the Supreme Court hearing a case.

Moreover, the D.C. Circuit's rehearing order in *Lucia* may spur renewed letter writing campaigns in other cases disputing the SEC's ALJs. The Federal Rules of Appellate Procedure allow parties to apprise courts of new legal authority.

Lastly, D.C. Circuit Chief Judge Merrick Garland, who most recently was former President Obama's nominee to fill the Supreme Court vacancy left by Justice Antonin Scalia's passing, did not participate in either of today's orders in *Lucia* and *PHH*. President Trump has since nominated Judge Neil Gorsuch of the Tenth Circuit to replace Justice Scalia (Judge Gorsuch was not on the *Bandimere* panel).

Understanding *Landry*. In 2010, when the Supreme Court decided the similar [Free Enterprise](#) case involving the Public Company Accounting Oversight Board, Chief Justice John Roberts's majority opinion left open the question of whether the Article II issues that impacted the structure of the PCAOB likewise could impact the SEC or other federal agencies. Footnote 10 of the majority opinion specifically noted the controversy over the D.C. Circuit's *Landry* decision. The majority ultimately crafted a solution that severed the offending dual for-cause provision and, thus, upheld the PCAOB as an institution.

By contrast, Justice Stephen Breyer penned a lengthy dissent, joined by three other justices, that painted a contrary picture of a federal government wracked by uncertainty and strained to administer the laws under *Free Enterprise*. To emphasize his view, Justice Breyer included several appendices describing the potential impact of *Free Enterprise* on federal agencies, including one showing the numbers of ALJs that could be affected at agencies like the SEC and the CFTC, at least as of June 2010, the date of the court's opinion.

Beyond the brief mention of *Landry*, the Supreme Court in *Free Enterprise* had little to say about the D.C. Circuit case. In *Landry*, the FDIC sought to remove a bank executive from this position and to bar him from holding any similar job at an FDIC-insured bank. The FDIC assigned an ALJ who then recommended the

executive's removal and bar. Following an appeal, the FDIC board issued a final decision upholding the ALJ's recommendation. The D.C. Circuit later denied the bank executive's petition for review of the FDIC's decision.

A majority of the *Landry* panel emphasized that the FDIC's ALJs lacked final decision making powers and bolstered this view by distinguishing the Supreme Court's *Freytag* opinion, which had found the U.S. Tax Court's Special Trial Judges were inferior officers because they were final in at least some types of matters. Judge A. Raymond Randolph partially concurred and concurred in the judgment: He agreed there was no prejudicial error in the case, but disagreed with the majority's view that finality was "critical" in *Freytag*.

Judge Randolph first noted that the Supreme Court's decision to hear *Freytag* was not dependent on the deference accorded to STJs in some instances. He also chided the majority for giving too much weight to the "alternative" nature of the *Freytag* finality holding. According to Judge Randolph, the Supreme Court would have reached the same conclusion if the STJs had lesser duties; Judge Randolph noted a prior paragraph in *Freytag* suggesting that the STJs could be inferior officers even if they did not issue final decisions.

Landry has played a key role in the many court opinions at both the district and appellate level in the SEC ALJ cases. The Commission too has found that its ALJs satisfy the Constitution for purposes of the agency's in-house proceedings against [Lucia](#) and [Bandimere](#). But Acting Chairman Michael Piwowar (then-Commissioner) and Commissioner Daniel Gallagher [dissented](#) from the Commission's majority opinion in the *Lucia* matter, saying that federal Article III judges should decide the constitutional issue, even if the Commission can express an opinion about its ALJs.

Impact on CFPB case. For those who followed a case disputing the SEC's conflict minerals rule through the D.C. Circuit rehearing process, the appellate court's linking of *Lucia* to *PHH* will suggest a familiar pattern. The conflict minerals issue arose at a time when the full court [mulled](#) similar First Amendment issues in another case involving food labeling. The panel rehearing the conflict minerals case had asked the parties to explain how the full court's decision in the other case ([AMI](#)) might impact the conflict minerals case (the panel majority eventually issued a [new opinion](#) that upheld and further explained the reasons for its prior decision).

Likewise, now that the full court has agreed to [rehear PHH](#), the court will consider how a decision in *Lucia* may impact PHH's case against the CFPB. Of interest to securities practitioners, the *PHH* order directs the parties to state how the full court should decide PHH if the full court in *Lucia* determines that the SEC's ALJ in that case is an inferior officer. As mentioned above, that will call upon the full court to rethink the *Landry* panel's majority and concurring opinions.

Previously, a D.C. Circuit panel [held](#) that the CFPB was unconstitutionally structured and ordered the for-cause removal provision that had enabled the CFPB's single-director, independent agency structure severed from its founding statute. That resolution tracked the Supreme Court's remedy for a similar issue regarding the PCAOB in *Free Enterprise*.

Moreover, the *PHH* order directs the parties to tell the court whether the Dodd-Frank Act-mandated independent agency status of the CFPB is consistent with Article II of the U.S. Constitution and whether the court can sever the for-cause provision. The order also asks whether the constitutional question can be avoided by instead focusing on statutory rulings in the case.

The case is [No. 15-1345](#).

Attorneys: Jonathan C. Dickey (Gibson Dunn & Crutcher LLP) for Raymond J. Lucia Companies, Inc. and Raymond J. Lucia. Michael Andrew Conley for the SEC.

Companies: Raymond J. Lucia Companies, Inc.; PHH Corporation

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