Securities Regulation Daily Wrap Up, ENFORCEMENT—S.D. Cal.: Lucia v. SEC 2.0 presses removal question left unanswered by Supreme Court, (Nov. 30, 2018)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

Raymond Lucia, whose win earlier this year in the Supreme Court netted him the right to a new SEC administrative proceeding before either the Commission itself or before a new administrative law judge, is moving forward with round two in his battle to avoid having to appear before an ALJ he still believes is unconstitutionally appointed. In June, the Supreme Court agreed with Lucia that SEC ALJs are inferior officers of the United States and, thus, must be appointed in conformance with the Appointments Clause of the U.S. Constitution. Lucia now argues that the SEC's compliance with this decision removes only part of the constitutional infirmity surrounding the agency's ALJs because they still enjoy too many layers of tenure protection (*Lucia v. SEC*, November 28, 2018).

The removal question. The Commission in 2015 found that Lucia aided and abetted Advisers Act violations by his eponymous company by failing to make full disclosures about back testing data used to explain Lucia's "Buckets of Money" investment strategy to attendees at seminars. The Commission imposed second-tier penalties of $50,000 on Lucia and $250,000 on Lucia's company. Lucia also was barred by the Commission from associating with any investment adviser or broker-dealer. Lucia's previous appeal made it to the Supreme Court via the statutorily prescribed route when he filed a petition for review in a federal circuit court.

In his new complaint, filed in federal court in Southern California, Lucia claims that the despite his administrative matter being assigned to a new ALJ post-Lucia, the proceeding against him still violates Article II of the U.S. Constitution because of the multiple ways in which good cause removal provisions in federal law protect ALJs from being removed from their positions; Lucia claims that these tenure protections involve both the SEC and the Merit Systems Protection Board (MSPB). According to Lucia: the MSPB can remove an ALJ only for good cause; MSPB members are removable by the president, but only for good cause; and SEC commissioners can only be removed for good cause. In Free Enterprise, the Supreme Court determined that the Public Company Accounting Oversight Board's dual for cause removal protection was unconstitutional, although the PCAOB as an institution could continue because the justices were able to sever the offending provisions from the Sarbanes-Oxley Act.

Lucia's complaint also recites the many ways in which he believes SEC in-house proceedings are inherently unfair. Lucia further emphasizes that the several deadlines imposed by SEC rules of practice for administrative proceedings have long since lapsed in his matter. Meanwhile, Lucia asserts that he has lost his profession and reputation without having had a hearing before a properly appointed ALJ and a resulting, valid merits decision. Lucia seeks a preliminary injunction and other declaratory relief from the SEC and from Chairman Jay Clayton and Acting U.S. Attorney General Matthew Whitaker, both of whom were sued in their official capacities.

In Lucia's Supreme Court case, the government eventually confessed error on the Appointments Clause question following the most recent change of Administration. The government also tried to persuade the court to take up the removal question then. But, as the first footnote in the Supreme Court's Lucia opinion explained, the court declined to take the removal question because it wanted lower courts to opine on the matter first. Justice Breyer, who concurred and dissented in Lucia, would have preferred that the court decide Lucia on statutory grounds because, in his view, the answer to the constitutional question the court decided depended partly on how the court would have answered the question about statutory for cause removal protections enjoyed by ALJs. Justice Breyer had previously voiced concerns in his Free Enterprise dissent about the potential consequences

that may flow if courts upend the administrative process at agencies across the federal government that use numerous ALJs.

Possible hurdle? One potential initial hurdle for Lucia's new suit will be whether the district court can exercise jurisdiction over it. When numerous other pre-Lucia SEC respondents filed similar suits in federal district court, many of those courts determined that they lacked jurisdiction because the applicable securities laws spelled out the appeals process, which contemplates that a respondent who endures an adverse ruling by the Commission will appeal to a federal circuit court.

Free Enterprise and three other cases (Elgin, McNary, and Thunder Basin) decided by the Supreme Court developed a rubric for evaluating when a federal district court can hear claims related to an administrative proceeding where the agency's governing statute requires a final agency decision to be appealed to a federal appellate court (i.e., it is "fairly discernible" Congress intended the claim to follow the statutory scheme). Thunder Basin, for example, suggested three factors that could justify taking a case out of the statutory scheme: (1) the potential for no meaningful judicial review; (2) claims that are wholly collateral to the administrative charges; and (3) claims that are outside the agency's expertise. Such cases typically involve a plaintiff who must figuratively and literally "bet-the-farm" to get judicial review of their claims. Lucia's complaint repeatedly emphasizes that without action by the district court, he will be unable to obtain meaningful judicial review.

The case is No. 18-cv-02692.

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