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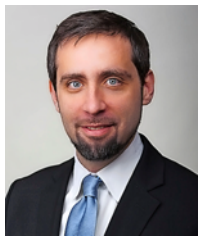
JURISDICTION AND PROCEDURE

The Appointment of SEC Administrative Law Judges: Constitutional Questions and Consequences for Enforcement Actions





By Peter D. Hardy, Carolyn H. Kendall, and Abraham J. Rein

For the past several years, the Securities and Exchange Commission ("SEC" or the "Commission") has been aggressively pursuing alleged violations of the nation's securities laws. In fiscal year 2014, the SEC brought a record number of new enforcement actions and fiscal year 2015 is on track to meet or exceed 2014's record.[1] In a marked shift from its historical practice, the SEC has brought the vast majority of these enforcement cases as administrative proceedings before the SEC's administrative law judges ("ALJs"), rather than as federal court cases.[2] Accompanying this increase in the use of administrative proceedings has been a concomitant increase in the SEC's success rate in enforcement actions, with the Commission winning 90% of its administrative proceedings and only 69% of its district court cases.[3]

Peter D. Hardy, Carolyn H. Kendall and Abraham J. Rein practice in the Internal Investigations & White Collar Defense Practice Group of the law firm of Post & Schell P.C., in Philadelphia, PA. Hardy, a principal with the firm, previously served as an assistant U.S. attorney in Philadelphia and as a trial attorney for the Department of Justice in Washington, D.C. Kendall and Rein are associates in the Philadelphia office. Hardy, Kendall and Rein have significant experience representing individuals and companies in matters involving allegations of financial fraud. They served as co-counsel in the first federal court action ever filed that sought to prevent an administrative enforcement proceeding by the Securities and Exchange Commission based on an alleged violation of Article II of the Constitution.

[1] *See, e.g.*, Sara Gilley, Heather Lazur, and Alberto Vargus, *SEC Focus on Administrative Proceedings: Midyear Checkup*, Law360.com (May 27, 2015), *available at* https://www.cornerstone.com/GetAttachment/19bf7104-14c7-4656-9d52-1cfe561967ed/2015-Midyear-Checkup-on-SEC-Administrative-Proceedings.pdf (last visited June 11, 2015) (reporting that 755 enforcement actions were brought in 2014 and over 300 enforcement actions were filed during the first half of 2015).

[2] *Id.* (noting that prior to the passage of the Dodd-Frank Act of 2010, which permits the SEC to obtain penalties in administrative proceedings that previously were available only in court actions, the SEC brought roughly 60% of its enforcement cases as administrative proceedings, and now brings more than 80% of its enforcement actions as administrative proceedings).

[3] Jean Eaglesham, *SEC Wins With In-House Judges*, Wall St. J. (May 6, 2015), *available at* http://www.wsj.com/articles/

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Facing the prospect of having to defend themselves in administrative proceedings with these odds and without the full procedural protections of federal court, parties have brought various constitutional challenges to the SEC's administrative proceedings and the ALJs who adjudicate them. Among these is the claim that the manner in which SEC ALJs are appointed violates the Appointments Clause of Article II of the Constitution. Recently, this claim, unlike other alleged constitutional infirmities, has gained traction in reviewing federal courts.[4] Success on the merits would yield a determination that the appointments of the SEC's five ALJs, which appear to have been made by administrative functionaries and not by any SEC Commissioner,[5] are unconstitutional. Such a determination could have far-reaching consequences for the SEC and litigants that have been or currently are subject to administrative proceedings.

This article sets forth the Appointments Clause challenge to the SEC's ALJs and discusses the potential ramifications for past, present, and future parties to SEC administrative enforcement proceedings, as well as potential arguments that the SEC might try to use to limit the impact of a successful Appointments Clause challenge.

SEC's Administrative Proceedings & ALJs

An SEC administrative proceeding is an in-house adjudication, litigated by SEC trial attorneys and governed by the SEC's Rules of Practice. There is no jury. Discovery is extremely limited – there generally are no depositions and defendants are entitled only to those documents in the SEC's investigative file that do not disclose the identity of a confidential source and are not privileged, attorney work product, or internal writings prepared by the SEC.[6] The discovery that is allowed is limited in its utility by the accelerated timetable on which SEC administrative proceedings are required to operate. The administrative hearing – akin to a trial – must take place no later than approximately four months after the SEC files its order instituting proceedings – akin to a complaint – and the SEC, at its discretion, can shorten this time to just one month.[7] The SEC Division of Enforcement must ''commence'' making discovery available within a week after filing its complaint.[8] As a result, respondents are afforded under four months, at a maximum, to review discovery and mount their case; by contrast, the SEC frequently spends years investigating and building its case. Additionally, the Federal Rules of Evidence do not apply, and traditionally-inadmissible evidence routinely is considered: ''[A]ll evidence that can conceivably throw any light upon the controversy at hand should normally be admitted.''[9]

The administrative proceeding is presided over by an SEC ALJ, an employee of the SEC, who serves as the finder of fact and law. SEC ALJs have career appointments, and are not subject to the probationary periods that apply to certain other government employees;[10] their salaries are specified by statute.[11] The ALJ's powers with respect to administrative proceedings are, in many respects, parallel to those of a trial court judge presiding over a bench trial: he or she has the power and discretion to rule on any motions, including pretrial motions for summary disposition;[12] conduct trials and take testimony;[13] order production of evidence[14] and rule on admissibility questions;[15] issue subpoenas and rule on applications to quash;[16] sanction parties if they are in contempt;[17] enter orders of default;[18] take notice, where appropriate, of facts not appearing in the record;[19] grant extensions of time[20] and dismiss for failure to meet deadlines;[21] et cetera.

The SEC ALJ, like a trial judge at a bench trial, ultimately decides whether the respondent has violated the law.[22] That decision is appealable to the Commission itself, although in many cases the Commission can simply deny a petition for review.[23] If the decision is not appealed, or if the Commission declines to review the ALJ's decision, the SEC enters an order that the ALJ's decision has become final, and ''the action of [the] administrative law judge . . . shall, for all purposes, including appeal thereof, be deemed the action of the Commission.''[24]

Recent Appointments Clause Challenges to SEC ALJs

Article II of the Constitution concerns ''Officers of the United States.'' Federal executive ''officers'' either are principal or inferior. Principal officers – generally those reporting directly to the President – must be nominated by the President and confirmed with the Senate's advice and consent. By contrast, inferior officers can be appointed in several ways: in the same manner as principal officers, by the President alone, by a Court of Law,

sec-wins-with-in-house-judges-1430965803?tesla=y (last visited June 11, 2015).

[4] *See, e.g.*, *Hill v. SEC*, No. 1:15-CV-1801-LMM, slip op. at 42 (N.D. Ga. June 8, 2015) (granting a preliminary injunction because the appointment of the SEC ALJ who was assigned to the plaintiff's case ''is likely unconstitutional in violation of the Appointments Clause'' of Article II).

[5] *See id.* at 41 (noting that the ''SEC concedes that Plaintiff's ALJ, James E. Grimes, was not appointed by an SEC commissioner''). Moreover, in a filing before the Commission, the SEC's Division of Enforcement acknowledged that the process for selecting and appointing ALJs does not involve approval by the Commissioners. Notice of Filing at 2-3, *In Re Timbervest*, Administrative Proceeding File No. 3-15519 (June 4, 2015), *available at* https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf.

[6] U.S. Securities and Exchange Commission, Rules of Practice (''RoP''), Rule 230.

[7] RoP 360.

[8] RoP 230.

[9] *In the Matter of Jay Alan Ochanpaugh*, Exchange Act Rel. No. 54363, 2006 SEC LEXIS 1926, *23 n.29 (Aug. 25, 2006) (citing *In the Matter of Jesse Rosenblum*, 47 S.E.C. 1065, 1072 (1984)).

[10] 5 C.F.R. § 930.204(a).

[11] 5 U.S.C. § 5372.

[12] *See, e.g.*, RoP 250(b).

[13] RoP 111.

[14] RoP 230(a)(2), 232.

[15] RoP 320.

[16] RoP 232.

[17] RoP 180.

[18] RoP 155.

[19] RoP 323.

[20] RoP 161.

[21] RoP 155.

[22] RoP 360.

[23] RoP 411(b)(2).

[24] 15 U.S.C. § 78d-1(c).

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or by the Head of a Department.[25] The Supreme Court has recognized that the Appointments Clause ''is more than a matter of 'etiquette or protocol'; it is among the significant structural safeguards of the constitutional scheme.''[26] Indeed, its purpose is to prevent encroachment by Congress upon the Executive Branch, in order to preserve ''the Constitution's structural integrity by preventing the diffusion of appointment power.''[27]

As recently held by a federal district court in the Northern District of Georgia, in *Hill v. SEC*, SEC ALJs likely represent inferior officers, and the appointment process for the ALJ overseeing respondent Hill's administrative proceeding likely violated the Appointments Clause. As a result of these two findings, the *Hill* court granted Hill's request for a preliminary injunction, enjoining the SEC, for now, from pursuing its administrative proceeding against him.[28]

The argument in *Hill* that SEC ALJs represent inferior officers under Article II was not entirely novel.[29] The key to the inferior officer inquiry is whether the individual exercises ''significant authority.''[30] SEC ALJs, who are permanent employees with positions created by statute, have considerable authority and discretion; among other powers, they hear evidence, make factual findings, apply legal principles in formal administrative adjudications, and are empowered to issue sanctions. In *Hill*, the district court found that the conclusion that SEC ALJs represent inferior officers flows directly from the Supreme Court's holding in *Freytag v. Commissioner*,[31] which ruled that analogous special tax trial judges are inferior officers.

The more novel development in *Hill* was the public concession by the SEC that, as a factual matter and at least as to the particular ALJ at issue in the case, the Commission had no role in appointing the ALJ. The plaintiff in *Hill* alleged in his complaint that SEC ALJs are ''not appointed by the President, the Courts, or the [SEC] Commissioners. Instead, they are hired by the SEC's Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resource functions, and the Office of Personnel Management.''[32] In response to this factual allegation, the SEC simply conceded that the ALJ at issue was not appointed by an SEC Commissioner.[33] Having already determined that SEC ALJs represent inferior officers, the *Hill* court quickly concluded that because the ALJ was not appointed appropriately under Article II, his appointment was ''likely unconstitutional in violation of the Appointments Clause.''[34]

Indeed, and consistent with *Hill*, Supreme Court precedent makes clear that an inferior officer, whose appointment Congress has entrusted to ''Heads of Departments,'' must in fact be appointed by the Head of the officer's Department. The Department Head cannot delegate his or her constitutional appointment authority to a designee or delegate, such as another Department official or employee[35] – much less to ''human resource functions'' or other administrative employees. As observed by the *Hill* court, the Supreme Court answered definitively the question of whether the SEC was a ''Department'' for purposes of the Appointments Clause in *Free Enterprise Fund v. Public Company Accounting Oversight Board*[36] by ruling that the Commission itself, and not the SEC Chairperson, was the Head – despite the counter-argument raised before the Court that ''finding the Commission to be the head will invalidate numerous appointments made directly by the Chairman.''[37]

However, the *Hill* court did not address a second line of argument that, in theory, could be available to the SEC: approbation. In order to permit appointment of inferior officers by means other than by the President with the Senate's advice and consent, Congress must pass legislation specifying those means of appointment. In some cases, Congress has chosen to provide for the appointment of inferior officers by someone other than the Head of a Department, with the Department Head's

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[25] *Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 493-94 (2010); U.S. Const., Art. II, § 2, cl. 2.

[26] *Edmond v. United States*, 520 U.S. 651, 659 (1997) (quoting *Buckley v. Valeo*, 424 U.S. 1, 125 (1976)).

[27] *Freytag v. Commissioner*, 501 U.S. 868, 878 (1991).

[28] *Hill v. SEC*, No. 1:15-cv-1801-LMM, 2015 BL 182985, (N.D. Ga. June 8, 2015). The SEC has indicated that it intends to appeal the ruling. Defendant's Response to the Court's Order of June 8, 2015 Regarding Further Proceedings in this Case at 1-2, *Hill v. SEC*, No. 15-cv-1801-LMM (N.D. Ga. June 15, 2015).

[29] The first federal district court civil action seeking to prevent the SEC from pursuing an administrative action in part because SEC ALJs represent inferior officers under Article II of the Constitution was *Stilwell v. SEC*, No. 14-cv-7931 (S.D.N.Y.), a case filed on October 1, 2014 by the authors and co-counsel at Skadden Arps Slate Meagher & Flom. This filing alleged a violation of the Supervision Clause under Article II of the Constitution. *See* Alison Frankel, Reuters, *Hedge fund's novel claim: SEC in-house judges are unconstitutional* (Oct. 2, 2014), *available at* http://blogs.reuters.com/alison-frankel/2014/10/02/hedge-funds-novel-claim-sec-in-house-judges-are-unconstitutional/ (last visited June 15, 2015) (discussing case and providing link to complaint). *See also* Securities Diary, *Challenges to the Constitutionality of SEC Administrative Proceedings in Peixoto and Stilwell May Have Merit* (Dec. 2, 2014), *available at* http://securitiesdiary.com/2014/12/02/challenges-to-the-constitutionality-of-sec-administrative-proceedings-in-peixoto-and-stilwell-may-have-merit/ (last visited June 17, 2015).

[30] *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

[31] 501 U.S. 868 (1991). The *Hill* court further cited the recent ruling by the Southern District of New York in *Duka v. SEC*, No. 15 Civ. 357 (RMB) (SN), 2015 BL 106007, *8 (S.D.N.Y. Apr. 15, 2015) (while rejecting motion for preliminary injunction to enjoin SEC administrative proceedings, nonetheless observing that SEC ALJs ''appear'' to be inferior officers under *Freytag*), and rejected the reliance of the SEC on *Landry v. Federal Deposit Insurance Corp.*, 204 F.3d 1125 (D.C. Cir. 2000) (panel opinion holding that SEC ALJs are not inferior officers). *See also Samuels, Kramer & Co. v. Comm'r of Internal Revenue*, 930 F.2d 975, 985-86 (2d Cir. 1991) (citing *Buckley*, 424 U.S. at 126 and holding that special tax trial judges are inferior officers).

[32] 2015 BL 182985 at *3–4.

[33] *Id.* at *19.

[34] *Id.*

[35] *Burnap v. United States*, 252 U.S. 512, 515 (1920); *United States v. Germaine*, 99 U.S. 508, 511 (1879).

[36] 561 U.S. 477, 493-94 (2010).

[37] *Id.* at 512 n.13 (internal quotation marks omitted) (citation omitted) (quoting Reorg. Plan No. 10, § 1(b)(2), at 1266, which provides that ''appointment by the [SEC] Chairman of the heads of major administrative units under the Commission shall be subject to the approval of the Commission''). The Court also explained that it has ''previously found that the department head's approval satisfies the Appointments Clause, in precedents that petitioners do not ask us to revisit.'' *Id.* (citing *United States v. Smith*, 124 U.S. 525, 532 (1888) and *United States v. Hartwell*, 73 U.S. (6 Wall.) 385, 393-94 (1868)).

consent or approval explicitly required by statute. The Supreme Court has held that these appointments satisfy the Appointments Clause.[38] This is known as ''approbation.'' Thus, Congress, but not a Department Head, can delegate appointment authority, so long as the Department Head's approval or consent still is required. For a Department Head's approbation to cure an otherwise unconstitutional appointment of an inferior officer by a subordinate, the Department Head's approval still likely must be explicitly required by statute.[39] In the case of SEC ALJs, the means of their appointment are specified by the Administrative Procedure Act (''APA''), which states: ''Each agency shall appoint as many administrative law judges as are necessary for proceedings required to be conducted in accordance with sections 556 and 557'' of the APA.[40] Importantly, the APA does not expressly permit any person or entity, other than the ''agency,'' to appoint ALJs. Thus, any approbation of SEC ALJs' appointment would lack statutory authority and likely be insufficient to cure any constitutional defect in their appointment. Perhaps more importantly, the complete failure by the SEC to even raise the issue of approbation in *Hill* suggests that, as a factual matter, the Commissioners never provided any consent or approval.

Finally, and to issue its preliminary injunction, the *Hill* court had to dispense with subject matter jurisdiction claims raised by the SEC. Specifically, the district court rejected the SEC's claims that exclusive jurisdiction over the Appointments Clause claim rested in the administrative proceeding because (i) Hill could obtain meaningful judicial review by appealing to the federal court of appeals; (ii) the constitutional claim was not wholly collateral to the SEC proceeding; and (iii) adjudication of the constitutional claim was not wholly outside the SEC's expertise. Although these jurisdictional issues are central to the ability of any respondent undergoing an ongoing or threatened administrative action to obtain injunctive relief, we note them here only. We now will focus on the possible consequences for future SEC administrative proceedings, if the correctness of the substantive Appointments Clause claim becomes accepted.

The Ramifications of an Unconstitutional Appointment Regime

If courts continue to follow *Hill*'s well-reasoned approach and hold that SEC ALJs' appointments are unconstitutional, some parties likely will be able to challenge the judgments already issued against them by ALJs in administrative proceedings. However, and as discussed below, not all parties who have been subject to administrative proceedings before unconstitutionally-appointed ALJs would be able to successfully attack the validity of the ALJs' rulings in their cases. Perhaps the most interesting question is the fate of future enforcement actions.

Parties Whose Administrative Determinations Are Final. Courts' ability to correct errors, including serious structural or jurisdictional errors, is constrained by the principle of finality. Once a judgment has become final, *i.e.*, the time to seek direct review has expired or a petition for *certiorari* has been denied, it typically cannot be attacked collaterally, absent extraordinary circumstances outweighing the presumption in favor of finality.[41] Perhaps surprisingly, the decision-maker's lack of constitutional authority to issue the judgment does *not* outweigh the interest in finality. Indeed, courts will not set aside final judgments on a mere showing that the adjudicator lacked subject matter jurisdiction.[42] Subject matter jurisdiction is a prerequisite to a court's exercise of power; without it, any order or decision is void.[43] A court without subject matter jurisdiction is analogous to an adjudicator, such as an ALJ, who was appointed improperly and therefore lacked power or authority to exercise jurisdiction over the case before him.[44]

The Supreme Court has made clear that even when the adjudicator lacked the power to decide the case, once a judgment has become final, the defect cannot be raised collaterally.[45] Therefore, it is likely that parties whose SEC ALJ-issued judgments are final will be unable to successfully attack them collaterally based on a determination that the ALJs' appointments were unconstitutional.

Parties Whose Administrative Determinations are Not Yet Final. Parties that currently are in administrative proceedings or whose judgments are not yet final (because they still are on direct review or the period for seeking direct review has not yet expired) likely will be able to use a determination that the appointments of the SEC's ALJs are unconstitutional to void their administrative adjudications.

The Supreme Court consistently has held that a judgment entered by an improperly appointed adjudicator is void[46] and ''should certainly be set aside or quashed by any court having authority to review it by appeal, error or *certiorari*.''[47] For example, the Supreme Court in *Ryder v. United States*[48] vacated several decisions made by the Coast Guard Court of Military Review because the appointments of two of the court's officers

[38] *See, e.g., Smith*, 124 U.S. at 532; *Hartwell*, 73 U.S. (6 Wall.) at 393-94.

[39] *Smith*, 124 U.S. at 531-33; *Hartwell*, 73 U.S. (6 Wall.) at 393-94.

[40] 5 U.S.C. § 3105.

[41] *See Durfee v. Duke*, 375 U.S. 106, 114-15 (1963). *See also James B. Beam Distilling Co. v. Georgia*, 501 U .S. 529, 540 (1991) (holding that ''in the civil arena, there is little opportunity for collateral attack of final judgments'').

[42] *See, e.g., Durfee*, 375 U.S. at 111-12; *Chicot Cnty. Drainage Dist. v. Baxter State Bank*, 308 U.S. 371, 376 (1940); *Stoll v. Gottlieb*, 305 U.S. 165, 176–77 (1938).

[43] *Gonzalez v. Crosby*, 545 U.S. 524, 534 (2005) (discussing ''obtain[ing] vacatur of a judgment that is void for lack of subject matter jurisdiction'').

[44] *See, e.g., American Constr. Co. v. Jacksonville, T. & K. W. R. Co.*, 148 U.S. 372, 387 (1893) (noting that if an adjudicator is ''incompetent to sit at the hearing, [then] the decree in which he took part was unlawful, and perhaps absolutely void'').

[45] *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 154 (2009) (noting that if the ''law were otherwise, and courts could evaluate the jurisdiction that they may or may not have had to issue a final judgment, the rules of *res judicata* would be entirely short-circuited'' (internal quotation marks omitted) (alteration omitted)).

[46] *United States v. L.A. Tucker Truck Lines*, 344 U.S. 33, 38 (1952) (holding that a defect in the appointment of an 'examiner' (ALJs' precursor) was, if properly raised, ''an irregularity which would invalidate a resulting order'').

[47] *American Constr. Co.*, 148 U.S. at 387 (1893); *Khanh Phuong Nguyen v. United States*, 539 U.S. 69, 73-74 (2003).

[48] 515 U.S. 177 (1995).

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violated the Appointments Clause.[49] Similarly, in *United States v. American-Foreign S.S. Corp.*,[50] the Court vacated a decision of the Second Circuit *en banc* in which a retired judge participated. The Court held that ''a retired circuit judge is without power to participate in an *en banc* Court of Appeals determination, and accordingly [held] that the judgment must be set aside.''[51] The Court also vacated decisions of the Ninth Circuit Court of Appeals made by a three-judge panel that included an Article IV territorial judge (a judge of the District Court for the Northern Mariana Islands) who was ineligible to sit by designation on an Article III court.[52]

In each of these cases, although the Supreme Court vacated the decisions of the improperly-appointed adjudicator, the Court then remanded the case back to the adjudicating body (*e.g.*, the Second Circuit, the Court of Military Review, or the Ninth Circuit) for a new decision made by a constitutionally-valid body.[53] In those cases, remand was possible because the constitutional appointment violation would not be repeated on remand because the case would be decided by other, properly appointed adjudicators. However, for parties challenging their administrative adjudications on the basis that the SEC's ALJs' appointments are unconstitutional, remand likely will not be an option for a reviewing court unless and until the SEC properly reappoints its ALJs or appoints new ALJs in conformity with the Constitution's requirements. To do otherwise would require remanding the case to an invalidly-appointed ALJ, thereby repeating the injury of adjudication before an unconstitutional ALJ.

Absent properly-appointed SEC ALJs to whom vacated decisions can be remanded, prior decisions by improperly-appointed ALJs likely will be voided and dismissed. However, these dismissals likely would be *without* prejudice.[54] This would permit the SEC, subject to the applicable statute of limitations, to bring the same charges in a later enforcement proceeding either before a properly-appointed ALJ or in federal court. Given the risk of re-adjudication, parties seeking to void their administrative adjudications should consider the possibility of having to incur the expense of a second enforcement proceeding and the risk of obtaining a different (and potentially less desirable) outcome.

The SEC presumably will try to avoid invalidation of its prior ALJ decisions. Although there are several potential theories available to the Commission, none is likely to be successful. First, the SEC might argue that application of the *de facto* officer doctrine, which ''confers validity upon acts performed by a person acting under the color of title even though it is later discovered that the legality of that person's appointment or election to office is deficient,''[55] prevents invalidation of the ALJs' decisions. Although the *de facto* officer doctrine appears to be a perfect fit for the case of ALJs whose appointments are determined to be invalid, the Supreme Court rejected the doctrine's application to Appointments Clause challenges in *Ryder v. United States*.[56] In *Ryder*, the Court explained that ''one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case is entitled to a decision on the merits of the question and whatever relief may be appropriate if a violation indeed occurred. Any other rule would create a disincentive to raise Appointments Clause challenges with respect to questionable judicial appointments.''[57]

Second, the SEC could invoke the theory of ratification, under general principles of agency law. According to the Restatement (Third) of Agency, ''ratification is the affirmance of an act by one for or on behalf of another at a time when he had no authority to do the act for the one in whose name it was done.''[58] As discussed above, an SEC ALJ's decision must be approved by the SEC, either expressly or tacitly, by the Commission's decision not to review the decision. Thus, the SEC could argue that although its agent, the ALJ, was unauthorized to decide the case before her, the SEC, which is properly appointed, ratified the ALJ's decision by approving it expressly or by declining to take it up for review.[59] This too likely will be insufficient to preclude vacation of decisions entered by improperly-appointed ALJs. As the Court of Appeals for the District of Columbia Circuit recognized in *Landry v. Federal Deposit Insurance Corp.*,[60] if a constitutionally-appointed principal officer's review of an order issued by an unconstitutionally-appointed officer ''could cleanse the violation of its harmful impact, then all such arrangements would escape judicial review.'' Indeed, such an arrangement essentially would make the Appointments

[49] *Id.* at 180-88.

[50] 363 U.S. 685 (1960).

[51] *Id.* at 691.

[52] *Khanh Phuong Nguyen*, 539 U.S. at 83.

[53] *Ryder*, 515 U.S. at 188 (holding that the petitioner ''is entitled to a hearing before a properly appointed panel of the court''); *American-Foreign S.S. Corp.*, 363 U.S. at 691 (remanding for further proceedings without the participation of the retired circuit judge); *Khanh Phuong Nguyen*, 539 U.S. at 83 (remanding ''to the Ninth Circuit for fresh consideration of petitioners' appeals by a properly constituted panel'').

[54] *See Havens v. Mabus*, 759 F.3d 91, 98 (D.C. Cir. 2014) (''A jurisdictional dismissal—which is not an adjudication on the merits under Rule 41(b)—is, then, a dismissal without prejudice.''); *Copeland v. Fortis*, 2010 BL 418389, No. 08 Civ. 9060 (DC), at *1-*2 (S.D.N.Y. May 20, 2010) (unpublished) (explaining that ''dismissal for lack of subject matter jurisdiction does not foreclose subsequent attempts to bring the suit in a court of competent jurisdiction''). Additionally, without a final judgment, *res judicata* also likely will not bar the SEC from bringing an enforcement action based on the same allegations. *See San Remo Hotel, L.P. v. City & Cnty. of S.F., Cal.*, 545 U.S. 323, 336 n.16 (2005) (noting that *res judicata* requires a ''final judgment on the merits'').

[55] *Ryder*, 515 U.S. at 180 (citing *Norton v. Shelby County*, 118 U.S. 425, 440 (1886)).

[56] *Id.* at 182-83.

[57] *Id.*

[58] Restatement (Third) of Agency § 4.02(b).

[59] According to the Wall Street Journal, the SEC may be planning on relying, at least in part, on ratification to defend against collateral attacks based on a judicial determination that SEC ALJs' appointments are unconstitutional. Jean Eagleshan, *Federal Judge Rules SEC In-House Judge's Appointment 'Likely Unconstitutional'*, WALL ST. J. (June 8, 2015), *available at* http://www.wsj.com/articles/federal-judge-rules-sec-in-house-judges-appointment-likely-unconstitutional-1433796161 (last visited June 11, 2015) (''SEC officials don't think rulings by agency judges . . . would be open to challenges in this way [*i.e.*, challenges based on a favorable Appointments Clause ruling], in part because the agency's commissioners sign off on the final decision in each case, a person close to the agency said.'').

[60] 204 F.3d 1125, 1132 (D.C. Cir. 2000).

Clause a nullity for inferior officers, since there would be no need to follow the Clause's requirements so long as a principal officer was prepared to ratify the unconstitutionally-appointed officer's acts. Moreover, the Supreme Court has made clear that a court reviewing an Appointments Clause challenge should not consider the merits of the decision rendered by the unconstitutionally-appointed adjudicator.[61] Thus, the SEC's review of an invalid order cannot cure its constitutional defect. This is because ''an Appointments Clause challenge runs deeper than any immediate adverse governmental action a plaintiff may seek to avoid; it also entails the plaintiff's subjection to an exercise of power by an unconstitutionally appointed officer.''[62]

Similarly unlikely to succeed is an argument that parties seeking to void their administrative adjudications should be barred from doing so because they failed to raise the unconstitutionality of the adjudicating ALJ's appointment earlier, *i.e.*, in the administrative proceeding itself or before the SEC. Leaving aside the inherent conflict of interest involved in an ALJ or the SEC ruling on such a challenge, the Supreme Court has stated that it is inappropriate to apply the doctrines of forfeiture or waiver to challenges to the adjudicator's authority. In *Khanh Phuong Nguyen v. United States*,[63] in which the Court addressed the improper inclusion of a territorial court judge on a Ninth Circuit appellate panel, the Court explained that although ''a failure to object to trial error ordinarily limits an appellate court to review for plain error[,]'' it would be ''inappropriate'' ''to ignore the violation[,]'' despite the plaintiffs' failure to raise the claim below.[64] This is consistent with the treatment of claims regarding a court's lack of subject matter jurisdiction, which can be raised ''at any time in the same civil action, even initially at the highest appellate instance.''[65]

As the foregoing demonstrates, it is likely that ALJ decisions that are not yet final can be voided if it is determined that the SEC ALJs' appointments were unconstitutional. Whether these cases will be remanded to the agency or dismissed will depend on the SEC's ability to properly appoint ALJs to rehear these cases.[66]

Parties Not Yet Subject to Administrative Enforcement Actions. As to parties against whom the SEC may bring future administrative enforcement proceedings, but against whom no such proceedings have commenced yet, a determination that the appointments under which the ALJs currently are operating were unconstitutional likely will be of little assistance in the long-term. The near term, however, may hold severe headaches for the SEC, which must decide how to proceed with numerous investigations that have been underway, sometimes for years, and which are not necessarily improving with age. Indeed, the SEC's emphasis on bringing increased numbers of enforcement actions depended in part upon the ready availability – and the related threat during settlement negotiations – of administrative proceedings, whose speed and efficiency gave the SEC tactical advantages.

If courts follow *Hill*'s reasoning and continue to find SEC ALJs' appointments to be constitutionally infirm, the SEC has – in theory – a relatively easy constitutional fix available: simply re-appoint the five existing ALJs using a constitutionally-appropriate procedure. Presumably, that procedure would involve a vote among the five Commissioners to re-appoint each ALJ. If the SEC can do that, and successfully agree upon five ALJs, it should be able to proceed with any planned enforcement action.

In the short term, however, such a theoretical fix may run afoul of real-world obstacles. The SEC may resist employing a new appointments procedure because it does not want to concede, as a practical matter, the merits of a legal claim that it currently disputes. Such resistance may continue until the issue is settled to the SEC's satisfaction, potentially by the Supreme Court. Moreover, the government at large, including the Department of Justice, which often serves as the litigation arm for many different agencies and departments, may face a more global quandary because this issue is not necessarily limited to just SEC ALJs; rather, it may imperil the legitimacy of many ALJs across the government. Even if the Commissioners agree in principle that the SEC will undertake a new process of appointing ALJs, the SEC is an independent agency, whose Commissioners notoriously do not always see eye to eye. When bureaucratic inertia that frequently interferes with agency action is combined with potential turf battles between individual Commissioners, it becomes plausible that the SEC will not succeed in effectively reconstituting its administrative courts, at least not quickly.

Indeed, the regulatory scheme surrounding ALJ appointments is complex, and could provide its own obstacles to ready re-appointment. For example, an agency must select appointees from a list of eligible candidates provided by the Office of Personnel Management (''OPM'') or obtain OPM's ''prior approval'' in

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[61] *Khanh Phuong Nguyen*, 539 U.S. at 80-81 (ruling that because the improperly-appointed judge lacked the power to participate in the judgment, it was ''inappropriate to accept the Government's invitation to assess the merits'' of the decision); *Ryder*, 515 U.S. at 186 (rejecting the government's claim that the Court should undertake harmless error review because, according to the government, ''petitioner suffered no adverse consequences from the composition of the court'' issuing the judgment on appeal); *American-Foreign S.S. Corp.*, 363 U.S. at 691 (ruling that ''the judgment [in which the improperly-appointed judge participated] must be set aside'' and noting that ''[i]n reaching this conclusion we intimate no view as to the merits of the underlying litigation'').

[62] *Pennsylvania v. United States*, 124 F. Supp. 2d 917, 922-23 (W.D. Pa. 2000).

[63] 539 U.S. 69 (2003).

[64] *Id.* at 80.

[65] *Kontrick v. Ryan*, 540 U.S. 443, 455-56 (2004).

[66] Clearly, invalidating all of the SEC's not-yet-final ALJ decisions would create significant practical difficulties for the Commission. However, other agencies have dealt with similar issues due to improperly appointed officers that have issued multiple decisions. For example, in 2014, the Supreme Court invalided roughly 700 decisions of the National Labor Relations Board (''NLRB'') in *NLRB v. Noel Canning*, 573 U.S. ___, 134 S. Ct. 2550 (2014), when the Court held that the Board had issued decisions from January 2012 through August 2013 without the required quorum because the appointment of three Board members was unconstitutional. *See,* G. Roger King and Bryan J. Leitch, *The Impact of the Supreme Court's Noel Canning Decision – Years of Litigation Challenges on the Horizon for NLRB*, Bloomberg Law (June 2, 2014), *available at* http://www.bna.com/impact-supreme-courts-n17179891624 (last visited June 11, 2015) (reporting statistics regarding invalidated decisions).

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order to appoint a candidate not on OPM's list.[67] OPM's list of eligible candidates includes applicants who have taken and passed the OPM's administrative law judge exam.[68] At least one current SEC ALJ – the chief judge – began working at the SEC in 1988, and ''information regarding hiring practices at that time is not readily available.''[69] According to an online biography, she was appointed chief judge in 1994, long before OPM's current ALJ exam was designed.[70] In the case of a position that is ''newly classified'' as an ALJ position, the agency has the ability to appoint the incumbent to the ALJ role under certain conditions – including when ''OPM determines the employee meets the qualification requirements and has passed the current examination for an administrative law judge position''[71] – again, a potential obstacle for at least some current ALJs. Further, ALJ promotions are governed by the civil service promotion rules, which are detailed and complex.[72] Accordingly, depending on how re-appointments are classified – as new appointments, as re-classifications of existing positions, as promotions, etc. – regulatory requirements may significantly slow the process.

An additional wrinkle stems from the statutory scheme for SEC ALJ compensation, which requires that, ''upon appointment'' to a position, the ALJ ''shall'' be paid at a particular rate, and that he or she ''shall be advanced successively'' through a scale of pay rates on a statutorily-set schedule.[73] This requirement could inhibit the SEC in its handling of this issue, because current ALJs are unlikely to be happy about a potential reading of the law requiring them to take an across-the-board pay cut.

Ultimately, if the Appointments Clause claim continues to be successful, the most reliable and immediate real-world fix available to the SEC is to relent on bringing enforcement actions administratively, and to return to the time-honored forum for adjudicating alleged securities violations: federal court. Indeed, it has been the SEC's own aggressive use of administrative proceedings, where it enjoys a much higher success rate than when it litigates before federal judges and juries, that has elicited the wave of constitutional challenges by respondents that, despite initial setbacks, now appears to be gaining traction as respondents creatively test the ALJ system and discover its weak points. Until the SEC solves its Appointments Clause issue, bringing all enforcement actions in federal court may be the only way for the SEC to ensure that it is using its resources effectively, rather than pursuing possible judgments that all may be voided.

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[67] 5 C.F.R. § 930.204(a).

[68] 5 C.F.R. § 930.201(e).

[69] Notice of Filing at 2-3, *In Re Timbervest*, Administrative Proceeding File No. 3-15519 (June 4, 2015), *available at* https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf.

[70] Yale Law School, Imprisoned – The Thirteenth Annual Liman Colloquium: Colloquium Speakers, *available at* http://www.law.yale.edu/documents/pdf/2010_Liman_Colloquium_Speakers.pdf (last visited June 14, 2015).

[71] 5 C.F.R. § 930.204(c)(4).

[72] 5 C.F.R. § 930.204(e); 5 C.F.R. § 335.103.

[73] 5 U.S.C. § 5372(b)(3). However, the statute offers a potential out to the SEC: the Office of Personnel Management is permitted to provide for ALJ appointment ''at an advanced rate'' ''under such circumstances as the Office may determine appropriate.'' *Id.*