

# Client Update

## D.C. Circuit Upholds Constitutionality of SEC's In-House Courts

### NEW YORK

Matthew E. Kaplan  
mekaplan@debevoise.com

### WASHINGTON, D.C.

Paul R. Berger  
prberger@debevoise.com

Robert B. Kaplan  
rbkaplan@debevoise.com

Julie M. Riewe  
jriewe@debevoise.com

Colby A. Smith  
casmith@debevoise.com

Jonathan R. Tuttle  
jrtuttle@debevoise.com

Ada Fernandez Johnson  
afjohnson@debevoise.com

Laura E. O'Neill  
leoneill@debevoise.com

On Tuesday, August 9, 2016, the U.S. Court of Appeals for the District of Columbia Circuit delivered a landmark victory to the U.S. Securities and Exchange Commission ("SEC" or "Commission") in *Raymond James Lucia Cos. Inc. v. S.E.C.*,<sup>1</sup> holding that the procedures for appointing the SEC's Administrative Law Judges ("ALJs") are consistent with the Appointments Clause of the Constitution. With this ruling, the D.C. Circuit becomes the first federal appellate court to directly address the recent constitutional challenges to the Commission's administrative proceedings.

Former investment adviser Ray Lucia had appealed the SEC's findings that he misled investors as to his firm's retirement wealth-management strategy in violation of Sections 206(1), 206(3) and 206(4) of the Investment Advisers Act of 1940. In contrast to the petitioners whose challenges were rejected on jurisdictional grounds in recent decisions by various federal appellate courts,<sup>2</sup> Lucia exhausted his appellate options within the Commission itself before pursuing his constitutional claims at the circuit court level. An ALJ had imposed a lifetime industry bar and \$300,000 in monetary penalties and disgorgement on Lucia in a December 2013 initial decision. Lucia appealed directly to the Commission, challenging the ALJ's conclusions and arguing that the ALJ was a constitutional "Officer" of the United States who had been unconstitutionally appointed and lacked authority to render a decision. The Commission upheld the ALJ's findings in a final Order issued September 2015.

<sup>1</sup> No. 15-1345 (D.C. Cir. Aug. 9, 2016).

<sup>2</sup> *Hill v. Secs. & Exch. Comm'n*, No. 15-13738 (11th Cir. June 17, 2016); *Tilton v. Secs. & Exch. Comm'n*, No. 15-2103, 2016 WL 3084795 (2d Cir. June 1, 2016); *Bebo v. Secs. & Exch. Comm'n*, 799 F.3d 765 (7th Cir. 2015), cert. denied, 136 S.Ct. 1500 (2016); *Jarkesy v. Secs. & Exch. Comm'n*, 803 F.3d 9 (D.C. Cir. 2015).

After laying out the statutory history behind the Commission's delegation of power to its ALJ function, the Court analyzed the Appointments Clause, which provides that the President nominate and appoint "Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law," and empowers Congress to "vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments."<sup>3</sup> Per Supreme Court precedent, Officers are defined as appointees who exercise "significant authority pursuant to the laws of the United States," which the D.C. Circuit evaluates based on the significance of the matters that they resolve, the level of discretion they hold in reaching those decisions and the finality of those decisions.<sup>4</sup> The SEC's ALJs are hired through the SEC's Office of Administrative Law Judges, rather than appointed through the constitutional processes for Officers.

The Court focused on the Commission's issuance of a final Order that either memorializes or alters an initial decision by an ALJ:<sup>5</sup> "The Commission's final action is either in the form of a new decision after *de novo* review or, by declining to grant or order review, its embrace of the ALJ's initial decision as its own. In either event, the Commission has retained full decision-making powers."<sup>6</sup> Noting that the Commission could affirm, reverse, modify, set aside or reach different findings from an ALJ's decision, and that the initial decision would be "of no effect" if a majority of participating Commissioners could not agree to an outcome on the merits, the Court determined that the ALJ's actions fell below the threshold of authority required to be considered an Officer.<sup>7</sup> As such, the Court determined, petitioners had offered no "reason to understand the finality order to be merely a rubber stamp."<sup>8</sup>

Because petitioners had failed to identify duties that would render the ALJs "inferior Officers" for constitutional purposes, the Court concluded that it "could not cast aside a carefully devised scheme established after years of legislative

---

<sup>3</sup> U.S. Const. art. II, § 2, cl. 2.

<sup>4</sup> *Raymond*, No. 15-1345 at 9, 10 (citing *Buckley v. Valeo*, 424 U.S. 1, 126 (1976); *Tucker v. Comm'r, Internal Revenue*, 676 F.3d 1129, 1133 (D.C. Cir. 2012)).

<sup>5</sup> See Securities Exchange Act of 1934, 15 U.S.C. § 78d-1(b) (2012); 17 C.F.R. § 201.360(d)(2).

<sup>6</sup> *Raymond*, No. 15-1345 at 13.

<sup>7</sup> *Id.* at 15-16.

<sup>8</sup> *Id.* at 15.

consideration and agency implementation.”<sup>9</sup> The Court went on to reject petitioner’s alternative argument that the Commission’s findings of liability lacked substantial support in the evidentiary record, and upheld the Commission’s decision to impose a lifetime bar as being within the Commission’s discretion.<sup>10</sup>

The decision by the D.C. Circuit is likely to influence the ultimate outcome of numerous similar constitutional challenges that have been raised across the country.<sup>11</sup> The Court’s analysis would apply directly, and with similar results, to claims stemming from the tenure protections that ALJs enjoy from the President’s authority to remove executive officers.<sup>12</sup> However, although arguments that ALJs are constitutionally infirm have largely focused on Article II issues, some petitioners have raised challenges based on a deprivation of their rights to due process, equal protection and a jury trial.<sup>13</sup> Other Circuits that entertain such challenges may also diverge from the reasoning in *Raymond*. Nonetheless, the D.C. Circuit’s ruling represents a major win for the SEC following several years of legal controversy over its administrative process.

\* \* \*

Please do not hesitate to contact us with any questions.

---

<sup>9</sup> *Id.* at 18.

<sup>10</sup> *Raymond*, No. 15-1345 at 19–31.

<sup>11</sup> For Debevoise’s previous coverage of constitutional challenges to ALJs, see Debevoise & Plimpton LLC, “Constitutional Challenges to the SEC’s Appointment of Administrative Law Judges,” *Insider Trading & Disclosure Update* vol. 2.2, pp. 23–24 (Dec. 2015), available at [http://www.debevoise.com/insights/publications/2015/12/insider-trading\\_disclosure\\_vol-2\\_iss-2](http://www.debevoise.com/insights/publications/2015/12/insider-trading_disclosure_vol-2_iss-2).

<sup>12</sup> See, e.g., *Duka v. S.E.C.*, 103 F.Supp.3d 382 (S.D.N.Y. 2015).

<sup>13</sup> See, e.g., *Chau v. S.E.C.*, 72 F. Supp. 3d 417 (S.D.N.Y. 2014); *Hill v. S.E.C.*, No. 15-13738 (11th Cir. June 17, 2016).