THE CONSTITUTIONALITY OF SEC ADMINISTRATIVE PROCEEDINGS: THE SEC SHOULD CURE ITS ALJ APPOINTMENT SCHEME

Kaela Dahan†

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† Articles Editor, *Cardozo Law Review*. J.D. Candidate (June 2017), Benjamin N. Cardozo School of Law; B.A., Touro College, 2014. I would like to thank Professor Jeanne Schroeder for her guidance as my Note advisor; Professor Michael Herz for generously reading many drafts of this Note and for contributing his vast knowledge in administrative law; and Bernard Tsepelman for his invaluable insight, advice, and support throughout the research and writing process. I would also like to thank the *Cardozo Law Review*'s talented team of editors, especially Joze Welsh, Melanie DeFiore, Sarah Ganley, Emma Guido, and Shannon Rozell, for their diligence, skill, and hard work in the final rounds of editing. Most importantly, I would like to thank my family for their endless support and encouragement.

INTRODUCTION

With the passage of section 929(P)(a)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in 2010,[1] Congress greatly expanded the authority of the Securities and Exchange Commission (SEC or Commission) to seek civil monetary penalties against unregistered persons through the use of "in house" administrative law courts.[2] The Securities Exchange Act of 1934 currently authorizes the SEC to bring enforcement actions against "any person" suspected of violating federal securities laws, and it gives the SEC sole discretion to decide whether to bring an action in federal court or as an administrative proceeding.[3] Prior to Dodd-Frank, the SEC could pursue civil penalties from unregistered individuals only in federal court.[4] Since Dodd-Frank, the SEC has brought an ever-

1 Dodd-Frank Wall Street Reform and Consumer Protection Act § 929(P)(a)(1), 15 U.S.C. § 77h-1 (2012).

2 *See* 15 U.S.C. § 77t(d)(1); *id.* § 78u(d)(3)(A); Bebo v. SEC, No. 15-C-3, 2015 U.S. Dist. LEXIS 25660, at *2 (E.D. Wis. Mar. 3, 2015) (Dodd-Frank "made the SEC's authority in administrative penalty proceedings 'coextensive' with its authority to seek penalties in federal court." (citation omitted)); Tyler L. Spunaugle, *The SEC's Increased Use of Administrative Proceedings: Increased Efficiency or Unconstitutional Expansion of Agency Power?*, 34 REV. BANKING & FIN. L. 406, 406 (2015); Thomas C. Frongillo & Caroline K. Simons, *SEC Looks to Tackle Insider Trading on Its Home Field—Defense Bar Claims Unnecessary Roughness*, FISH LITIG. BLOG (Dec. 5, 2014), http://www.fr.com/fish-litigation/sec-looks-to-tackle-insider-trading-on-its-home-field-defense-bar-claims-unnecessary-roughness; Jonathan Stempel, *Activist Investor Stilwell Sues SEC to Stop Enforcement Case*, YAHOO! FIN. (Oct. 1, 2014), http://finance.yahoo.com/news/activist-investor-stilwell-sues-sec-184924200.html.

3 15 U.S.C. § 78u(d); *id.* § 78u-2; *id.* § 78u-3; *see also* Thomas Glassman, *Ice Skating Up* Hill*: Constitutional Challenges to SEC Administrative Proceedings*, 16 J. BUS. & SEC. L. 47, 52 (2015).

4 *See* Greg D. Andres et al., *Securities Litigation Update: Constitutional Challenges to SEC's Administrative Courts Gain Momentum*, DAVIS POLK & WARDELL L.L.P. (Sept. 24, 2015), https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCAQFjAAahUKEwiMtJLflbvIAhVKOT4KHf2uDII&url=http%3A%2F%2Fwww.davispolk.com%2Fsites%2Fdefault%2Ffiles%2F2015-09-24_Constitutional_Challenges_to_SECs_Administrative_Courts_Gain_Momentum.pdf&usg=AFQjCNEeKQBA3ThYHHAwlND3bYUHU1aR9Q; Barrett Johnson & Stephen M. Juris, *Forum over Substance? Respondent Rights and the SEC*, LAW360 (July 14, 2015, 10:30 AM), http://www.law360.com/articles/678526/forum-over-substance-respondent-rights-and-the-sec;

increasing number of enforcement actions on its own turf, rather than in federal court.[5] This shift may be due, in part, to the "home court advantage" the SEC enjoys before its own Administrative Law Judges (ALJs).[6]

In light of this perceived bias, an increasing number of defendants have filed suit to enjoin the SEC from bringing its administrative proceedings and to require the SEC to litigate in federal court, alleging three constitutional deficiencies with the SEC's administrative proceedings and the ALJs who adjudicate them.[7] First, such defendants challenge the alleged lack of due process and concern for the rights afforded by the Seventh Amendment in the SEC's administrative law court, because they provide significantly fewer procedural protections for defendants than do federal courts.[8] That is, the SEC's administrative law courts do not give defendants the rights to a trial by jury, to discovery, or to immediate appellate review by a neutral arbitrator, and the Federal Rules of Evidence do not apply.[9] Second, defendants contend that the procedure for removing ALJs violates the Take Care Clause of the U.S. Constitution[10] because ALJs enjoy multiple layers of tenure protection.[11] Lastly, defendants maintain that the SEC's

Thomas K. Potter III, *A Renewed Fight over SEC's Admin Forum Constitutionality*, LAW360 (Oct. 9, 2014, 10:30 AM), http://www.law360.com/articles/585756/a-renewed-fight-over-sec-s-admin-forum-constitutionality; Spunaugle, *supra* note 2, at 407.

5 *See* discussion *infra* Part I.

6 *See* discussion *infra* Parts I–II. The SEC currently employs five ALJs: Jason S. Patil (appointed in 2014), James E. Grimes (appointed in 2014), Cameron Elliot (appointed in 2011), Carol Fox Foelak (appointed in 1994), and Brenda P. Murray, Chief ALJ (appointed in 1988). *See* Press Release, SEC, SEC Announces Arrival of New Administrative Law Judge (Sept. 22, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543014965; Press Release, SEC, SEC Announces Arrival of New Administrative Law Judge Cameron Elliot (Apr. 25, 2011), https://www.sec.gov/news/press/2011/2011-96.htm; Press Release, SEC, SEC Announces New Hires in the Office of Administrative Law Judges (June 30, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542202073; FCC, 13 DAILY DIGEST 127 (July 11, 1994), http://transition.fcc.gov/Daily_Releases/Daily_Digest/1994/dd071194.txt; SEC News Digest (Jan. 14, 1988), https://www.sec.gov/news/digest/1988/dig011488.pdf.

7 *See* Peter D. Hardy, Carolyn H. Kendall & Abraham J. Rein, *The Appointment of SEC Administrative Law Judges: Constitutional Questions and Consequences for Enforcement Actions*, 47 Sec. Reg. & L. Rep. (BNA) 1238 (June 22, 2015), http://www.postschell.com/site/files/post__schell__bloomberg_bna__sec_alj_constitutional_questions__6_19_15.pdf; discussion *infra* Part II.

8 *See* discussion *infra* Section II.A.

9 *See* Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011); discussion *infra* Section II.A.

10 U.S. CONST. art. II, § 3.

11 *See* Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial, Stilwell v. SEC, No. 14-cv-7931 (S.D.N.Y. Oct. 1, 2014); discussion *infra* Section II.B.

procedure for appointing ALJs violates the Appointments Clause of the Constitution.[12]

Of these alleged constitutional infirmities, the Appointments Clause issue is the one that is gaining traction in the courts.[13] Although many courts have ultimately held that the federal courts do not have subject matter jurisdiction to hear these constitutional challenges except through judicial review of an administrative proceeding,[14] there is now a split in opinion between two of the circuit courts of appeals regarding the constitutionality of the SEC's appointment scheme,[15] and a number of district courts that have opined on this issue have concluded that the SEC's appointment scheme *is* likely unconstitutional because the current ALJs have not been appointed by the SEC Commissioners.[16]

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12 *See* U.S. CONST. art. II, § 2, cl. 2; Hill v. SEC, 114 F. Supp. 3d 1297 (N.D. Ga. 2015), *vacated on other grounds and remanded*, 825 F.3d 1236 (11th Cir. 2016); discussion *infra* Section II.C.

13 *See* Ed Beeson, *SEC Says Its Judges Are Constitutional in Enforcement Ruling*, LAW360 (Sept. 4, 2015, 1:16 PM), http://www.law360.com/articles/699461/sec-says-its-judges-are-constitutional-in-enforcement-opinion; Hardy, Kendall & Rein *supra* note 7; *see also* MARK S. NELSON, WOLTERS KLUWER LEGAL & REG. SOLS. U.S. BRIEFING, THE SEC'S ALJS: CHANNELING THE APPOINTMENTS CLAUSE (2015), https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&ved=0ahUKEwiHmsb7upTOAhWGdh4KHdUZD3gQFggzMAM&url=https%3A%2F%2Flrus.wolterskluwer.com%2Fmedia%2FWK%2FLnB%2FPDF%2FSecurities%2FWhitepapers%2FSECs-ALJs-Channeling-Appointments-Clause&usg=AFQjCNGzSrLfVEHIG-RdPsiIdnqe7FpZag.

14 *See, e.g.*, *Hill*, 825 F.3d 1236 (vacating the district court's preliminary injunction orders in *Hill* and *Gray Financial Group, Inc. v. SEC* and remanding with instructions to dismiss the actions for lack of jurisdiction); Tilton v. SEC, No. 15-CV-2472, 2015 WL 4006165 (S.D.N.Y. June 30, 2015), *aff'd*, 824 F.3d 276 (2d Cir. 2016); Bebo v. SEC, No. 15-C-3, 2015 WL 905349 (E.D. Wis. Mar. 3, 2015), *aff'd*, 799 F.3d 765 (7th Cir. 2015); Bennett v. SEC, 151 F. Supp. 3d 632 (D. Md. 2015), *aff'd,* No. 15-2584, 2016 WL 7321231 (4th Cir. Dec. 16, 2016); Jarkesy v. SEC, 48 F. Supp. 3d 32 (D.D.C. 2014), *aff'd*, 803 F.3d 9 (D.C. Cir. 2015); *see also* Stewart Bishop, *Adviser Can't Halt SEC In-House Trial Pending Appeal*, Law360 (Jan. 22, 2016, 9:53 PM), http://www.law360.com/securities/articles/750034? nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities. For a more in-depth discussion on the issue of subject matter jurisdiction, see *infra*, note 189.

15 *Compare* Bandimere v. SEC, No. 15-9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016) (holding that the SEC's ALJs are "inferior officers" and thus have been appointed in violation of the Appointments Clause), *with* Raymond J. Lucia Cos., Inc. v. SEC, 832 F.3d 277 (D.C. Cir. 2016) (holding that the SEC's ALJs are mere "employees" and thus have not been appointed in violation of the Appointments Clause). *See also* Carmen Germaine, *SEC Wins 1st Appellate Ruling on In-House Constitutionality*, LAW360 (Aug. 9, 2016, 11:52 AM), http://www.law360.com/securities/articles/826489? nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities; Sarah A. Good & Laura C. Hurtado, *Constitutionality of SEC's Administrative Law Judges Headed to Supreme Court?*, PILLSBURY (Dec. 29, 2016), http://www.pillsburylaw.com/publications/constitutionality-of-secs-administrative-law-judges-headed-to-supreme-court.

16 *See* Ironridge Global IV, Ltd. v. SEC, 146 F. Supp. 3d 1294 (N.D. Ga. 2015), *appeal filed*, No. 16-10205 (11th Cir. Jan. 15, 2016); Duka v. SEC, 124 F. Supp. 3d 287 (S.D.N.Y. 2015), *vacated and remanded*, No. 15-2732 (2d Cir. June 13, 2016), *abrogated by Tilton*, 824 F.3d 276 (motion for reconsideration filed with the Second Circuit on July 27, 2016); Gray Fin. Grp., Inc.

Given these findings, and the SEC's stated intention to bring a greater percentage of cases as administrative proceedings,[17] the number of constitutional challenges from defendants will likely only increase and a battle before the Supreme Court of the United States is imminent.[18] Therefore, in order to continue using its administrative forum, the SEC can and should cure its appointment scheme and reappoint its ALJs through a process that is not constitutionally suspect.[19] This Note argues that although the process of reappointing the ALJs may be difficult, the benefits of administrative law courts, such as expertise and efficiency, outweigh the complexity of changing the appointment scheme.[20]

This Note proceeds in four parts. Part I reviews a brief history of SEC administrative proceedings, and the stimuli for the SEC's recent shift to bringing its enforcement actions in administrative proceedings. Part II summarizes the three constitutional arguments that defendants have raised against the use of administrative proceedings and the ALJs who adjudicate them, focusing on the Appointments Clause issue in particular. Part III summarizes the SEC's current predicament and explains why the SEC should cure the appointment scheme in a manner that indisputably complies with the Appointments Clause, outlining three alternative procedures for the SEC to adopt in achieving this goal in conformance with the Constitution.

I. THE HISTORY AND CURRENT STATUS OF SEC ADMINISTRATIVE PROCEEDINGS

A. *What Is an SEC Administrative Proceeding?*

An SEC administrative proceeding is an "in-house adjudication," presided over by one of the five SEC ALJs,[21] and governed by the SEC's

v. SEC, 166 F. Supp. 3d 1335 (N.D. Ga. 2015), *vacated and remanded sub nom. Hill*, 825 F.3d 1236; *Hill*, 114 F. Supp. 3d 1297, *vacated on other grounds and remanded*, 825 F.3d 1236.

17 *See* Geoffrey F. Aronow, *Back to the Future: The Use of Administrative Proceedings for Enforcement at the CFTC and SEC*, 35 FUTURES & DERIVATIVES L. REP. 1 (2015); Jessica Corso, *SEC Won't Slow Down Post-*Newman*, GC Says*, LAW360 (Sept. 18, 2015, 9:58 PM), http://www.law360.com/articles/704798/sec-won-t-slow-down-post-newman-gc-says; Yin Wilczek, *SEC to Pursue More Insider Trading Cases in Administrative Forum, Director Says*, 12 Corp. L. & Accountability Rep. (BNA) 651 (June 13, 2014), http://www.bna.com/sec-pursue-insider-n17179891282.

18 *See* Good & Hurtado, *supra* note 15; Johnson & Juris, *supra* note 4.

19 *See* discussion *infra* Parts III–IV.

20 *See* discussion *infra* Parts III–IV.

21 *See* 5 U.S.C. § 3105 (2012) ("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 this title. Administrative law judges shall be assigned to cases in rotation so far as

Rules of Practice.[22] The SEC brings a case in its administrative law courts by issuing an Order Instituting Proceedings, which provides the defendants with notice and an opportunity for a hearing.[23] Thereafter, the defendant may file an answer to the SEC's allegations,[24] make a motion for summary disposition,[25] or negotiate a settlement.[26] Should none of these pre-trial alternatives succeed, a formal hearing occurs, after which the ALJ, who serves as both the finder of fact and of law, will render an initial decision.[27] The initial decision of the ALJ can be appealed by either the defendant or the SEC's Division of Enforcement,[28] and is then subject to *de novo* review by the Commissioners,[29] where the Commissioners can permit the submission of additional evidence.[30] However, the Commissioners have the discretion to deny a petition for review, in which case the decision of the ALJ becomes the final decision.[31] Only if the final decision is adverse to

practicable, and may not perform duties inconsistent with their duties and responsibilities as administrative law judges."); *see also* 17 C.F.R. § 201.110 (2016) ("All [SEC administrative] proceedings shall be presided over by the Commission or, if the Commission so orders, by a hearing officer. When the Commission designates that the hearing officer shall be an administrative law judge, the Chief Administrative Law Judge shall select, pursuant to 17 C.F.R. 200.30-10, the administrative law judge to preside.").

22 *See* 5 U.S.C. § 556; Ryan Jones, Comment, *The Fight over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 507, 509 (2015); Hardy, Kendall & Rein, *supra* note 7.

23 17 C.F.R. § 201.200.

24 *Id.* § 201.220.

25 *Id.* § 201.250. The respondent may file a pre-trial motion for summary disposition only with leave from the ALJ, and denials of such leave are not appealable. *Id.*

26 *Id.* § 201.240.

27 *Id.* § 201.360. The ALJs also have the power to "rule on preliminary motions, conduct pre-hearing conferences, issue subpoenas, conduct hearings . . . , review briefs," etc. U.S. Office of Pers. Mgmt., *Qualification Standard for Administrative Law Judge Positions*, OPM.GOV, https://www.opm.gov/policy-data-oversight/classification-qualifications/general-schedule-qualification-standards/specialty-areas/administrative-law-judge-positions/ (last visited Oct. 28, 2015).

28 17 C.F.R. § 201.410; *see* Glassman, *supra* note 3, at 53.

29 17 C.F.R. § 201.411(a); Kenneth B. Winer & Laura S. Kwaterski, *Assessing SEC Power in Administrative Proceedings*, LAW360 (Mar. 24, 2011, 1:47 PM), http://www.law360.com/articles/233299/assessing-sec-power-in-administrative-proceedings; Glassman, *supra* note 3, at 53. The SEC generally has five Commissioners who are appointed by the President with the advice and consent of the Senate. Their terms last five years. There are currently two vacancies on the Commission. Mary Jo White has been the Chairwoman of the Commission since 2013, and her term expires in 2019. Kara M. Stein was appointed Commissioner in 2013, and her term expires in 2017. Michael S. Piwowar has served as Commissioner since 2013, and his term expires in 2018. *See Current SEC Commissioners*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/commissioner.shtml (last visited Dec. 29, 2015).

30 *See* 17 C.F.R. § 201.452; Glassman, *supra* note 3, at 53.

31 *See* 17 C.F.R. § 201.411.

the defendant may he appeal the SEC's determination to the federal courts.[32]

B. *How Are Administrative Law Judges Appointed?*

Appointment of ALJs, unlike that of Article III judges, does not require presidential nomination or Senate confirmation.[33] Pursuant to 5 U.S.C. § 3105, an administrative agency may select as many ALJs "as are necessary" for the agency to conduct administrative proceedings.[34] Although the administrative agency itself hires its ALJs, the Office of Personnel Management (OPM) is exclusively responsible for the "initial examination, certification for selection, and compensation of ALJs."[35] ALJs are selected through a merit selection process that is governed by OPM and publicized on the federal government's job listing website.[36] Under this process, OPM periodically conducts competitive examinations and uses the results of these examinations to rank applicants for ALJ positions according to their qualifications and skills.[37] The exam tests the applicant's ability to draft decisions and analyze relevant legal issues.[38]

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32 *See* 15 U.S.C. § 78y(b) (2012); Duka v. SEC, 124 F. Supp. 3d 287 (S.D.N.Y. 2015), *vacated and remanded*, No. 15-2732 (2d Cir. June 13, 2016).

33 *See* Kent Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 804 (2013); L. Harold Levinson, *The Status of the Administrative Judge*, 38 AM. J. COMP. L. (SUPPLEMENT) 523, 532–33 (1990); discussion *infra* Section II.C.

34 5 U.S.C. § 3105.

35 *See* VANESSA K. BURROWS, CONG. RESEARCH SERV., RL34607, ADMINISTRATIVE LAW JUDGES: AN OVERVIEW 2 (2010) (footnote omitted), http://ssaconnect.com/tfiles/ALJ-Overview.pdf; Jeffrey S. Lubbers, *Federal Administrative Law Judges: A Focus on Our Invisible Judiciary*, 33 ADMIN. L. REV. 109, 112 (1981). OPM is an independent agency responsible for personnel management of the civil service of the federal government. *See* U.S. Office of Pers. Mgmt., *Our Mission, Role & History*, OPM.GOV, https://www.opm.gov/about-us/our-mission-role-history (last visited Dec. 29, 2015). For more information on the role of OPM in the ALJ hiring process see *Role of Social Security Administrative Law Judges: Joint Hearing Before the Subcomm. on Courts, Commercial & Admin. L. of the H. Comm. on the Judiciary and the Subcomm. on Soc. Sec. of the H. Comm. on Ways & Means*, 112th Cong. 48 (2011) (statement of Christine Griffin, Deputy Director, U.S. Office of Personnel Management).

36 *See* 5 U.S.C. § 1302; BURROWS, *supra* note 35, at 2. *See generally* USAJOBS, https://www.usajobs.gov (last visited July 24, 2016).

37 *See* 5 C.F.R. § 337.101(a) (2016) ("OPM shall prescribe the relative weights to be given subjects in an examination, and shall assign numerical ratings on a scale of 100. Except as otherwise provided in this chapter, each applicant who meets the minimum requirements for entrance to an examination and is rated 70 or more in the examination is eligible for appointment.").

38 *See* Barnett, *supra* note 33, at 804.

OPM sets the minimum qualification standards for ALJ selection.[39] Applicants must be licensed attorneys "authorized to practice law under the laws of a State, the District of Columbia, the Commonwealth of Puerto Rico, or any territorial court," who have at least seven years of experience in "preparing for, participating in, and/or reviewing formal hearings or trials involving litigation and/or administrative law."[40] Applicants who meet these requirements and pass the examination are then given a score and placed on a "register" of eligible hires. Agencies may then select an ALJ from the top three highest-ranking candidates.[41]

C. *How Are the SEC's ALJs Appointed?*

Neither the general provisions of the U.S. Code governing selection of ALJs, nor OPM's regulations, nor any SEC-specific statute sets forth any rules for the hiring agency's *internal* mechanisms and processes for the appointment.[42] In fact, the Securities Exchange Act of 1934 gives the Commission vast discretion as to the hiring process for ALJs.[43] Although there is no formal, written statement of the process for the appointment of SEC ALJs, it has been proven that the ALJs are appointed through a process that includes the SEC's Office of ALJs, with input from the Chief ALJ, human resources, and OPM.[44] The SEC has conceded that most of its ALJs have not been appointed by the Commissioners in conformance with the Appointments Clause,[45] and in

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39 *See* 5 C.F.R. § 930.201; Barnett, *supra* note 33, at 804; U.S. Office of Pers. Mgmt., *supra* note 27.

40 5 C.F.R. § 930.204(b); BURROWS, *supra* note 35, at 2; *see also* Barnett, *supra* note 33, at 804; Jesse Etelson, *The New ALJ Examination: A Bright, Shining Lie Redux*, 43 ADMIN. L. REV. 185, 191–93 (1991); U.S. Office of Pers. Mgmt., *supra* note 27.

41 BURROWS, *supra* note 35, at 2; Barnett *supra* note 33, at 804–05.

42 The Securities Exchange Act of 1934 gives the Commission wide discretion as to the hiring process for "examiners," a term that includes ALJs, who were called "hearing examiners" at the time the Exchange Act became law.

43 *See* 15 U.S.C. § 78d(b)(1) (2012); 5 U.S.C. § 4802(b). For a further discussion on these statutes, see *supra* Part IV.

44 *See* Alexander I. Platt, *SEC Administrative Proceedings: Backlash and Reform*, 71 BUS. LAW. 1, 4 (2015); Carl Smith, *Storm at SEC over Appointments Clause Violations Concerning Its ALJs and Possible Implications as to Circular 230 ALJs, Part I*, PROCEDURALLY TAXING (Sept. 3, 2015), http://www.procedurallytaxing.com/storm-at-sec-over-appointments-clause-violations-concerning-its-aljs-and-possible-implications-as-to-circular-230-aljs-part-i; Bradley J. Bondi et al., *Recent Cases Consider Challenges to Constitutionality of SEC's Administrative Law Judges*, CAHILL GORDON & REINDEL L.L.P. (July 31, 2015), http://www.cahill.com/publications/firm-memoranda/10130381/_res/id=Attachments/index=0/Recent%20Cases%20Consider%20Challenges%20to%20Constitutionality%20of%20SEC's%20Administrative%20Law%20Judges.pdf.

45 The SEC has acknowledged that ALJ Elliot, ALJ Foelak, and ALJ Grimes were "not hired through a process involving the approval of the individual members of the Commission." *See Hill v. SEC*, 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015); Aff. of Jayne L. Seidman, Timbervest,

some instances, the SEC has not even been able to *correctly* identify exactly who signed off on the appointment or the exact process by which the ALJ was appointed.[46]

D. *The Statutory History of the SEC's Power to Impose Monetary Penalties in Its Administrative Proceedings*

Congress created the SEC in 1934[47] with the general purpose of preventing fraud and requiring "full disclosure[s] to allow investors to make informed decisions."[48] For the first fifty years of the SEC's existence, the SEC did not have the authority to seek monetary penalties.[49] The SEC could go to court to seek an injunction to stop or

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L.L.C., No-315519 (SEC June 4, 2015); Respondents' Petition for Review at 11, Spring Hill Capital Markets, L.L.C., Exchange Act Release No. 76772, 2015 WL 9425902 (Dec. 24, 2015) (citing hearing on the application for a preliminary injunction in *Tilton v. SEC* that ALJ Foelak was not appointed by the SEC Commissioners).

46 For example, in *In re Timbervest, L.L.C.*, the SEC submitted a Notice of Filing, which set forth that, since 2011, when the Commission seeks to hire a new ALJ, Chief ALJ Murray obtains from OPM a list of eligible candidates and a selection is made from the top three candidates on that list. Notice of Filing, *Timbervest, L.L.C.*, No. 3-15519, at 2 (Sec. Exch. Comm'n June 4, 2015). Chief ALJ Murray and an interview committee then makes a preliminary selection from among the available candidates, which is then subject to final approval by the Commission's Office of Human Resources. *Id.* As for the ALJs that were hired prior to 2011, the SEC's Notice left it completely unclear how they were hired—including ALJ Murray—

> As for earlier hires, it is likely the Commission employed a similar, if not identical, hiring process. But the Division acknowledges that it is possible that internal processes have shifted over time with changing laws and circumstances, and thus the hiring process may have been somewhat different with respect to previously hired ALJs. For instance, Chief ALJ Murray began work at the agency in 1988 and information regarding hiring practices at that time is not readily accessible.

Id. at 2–3. However, nearly three weeks after the SEC's filing, defendants learned that the SEC's account of how ALJ Elliot was hired was "erroneous." See Notice, *Timbervest*, No. 3-15519 (SEC June 23, 2015) and attached June 18, 2015 Hearing Transcript in *Bebo*, File No. 3-16293 at 4411. During the next hearing date in the *Bebo* proceeding, ALJ Elliot recounted how he was actually hired: he responded to an advertisement. For the SEC ALJ position, ALJ Elliot responded to an advertisement on usajobs.gov and sent in his resume. *Id.* at 4472. Chief Judge Murray, Ms. Seidman, and an attorney from the General Counsel's office interviewed ALJ Elliot. *Id.* at 4473. "[S]omeone in HR" then signed off on ALJ Elliot's hiring and OPM approved his transfer from the Social Security Administration. *Id.* at 4474. ALJ Elliot then went on to confirm that "[t]he bottom line, for purposes of the Article II arguments . . . I was not appointed by the Commission." *Id.*

47 Securities Exchange Act of 1934, 15 U.S.C. § 78d.

48 Matthew P. Wynne, Note, *Rule 10b-5(b) Enforcement Actions in Light of* Janus*: Making the Case for Agency Deference*, 81 FORDHAM L. REV. 2111, 2116 (2013); Frank H. Easterbrook & Daniel R. Fischel, 70 VA. L. REV. 669, 669 (1984); Jones, *supra* note 22, at 510.

49 Jon Eisenberg, *Brother Can You Spare $8.9 Billion? Making Sense of SEC Civil Money Penalties*, K&L GATES (Feb. 11, 2014), http://www.klgates.com/files/Publication/7b9cf03a-e90d-4bba-a373-bb494b063f9b/Presentation/PublicationAttachment/e5d51e6b-f798-4bf7-80be-

prevent violations of securities laws, it could seek a court order directing a defendant to disgorge profits gained as a result of such violations, and it could ban securities firms and professionals from the securities trade.[50] In certain situations, it could also seek these remedies in administrative proceedings for violations of securities laws such as faulty registration statements concerning public distributions of securities.[51]

However, in 1984, with the passage of the Insider Trading Sanctions Act,[52] Congress began to allow the SEC to pursue monetary penalties,[53] but only by going to federal court.[54] Four years later, Congress passed the Insider Trading and Securities Fraud Enforcement Act of 1988,[55] which gave the Commission authority to seek monetary penalties not only against the person who committed the violation, but also against a person who, at the time of the violation, "directly or indirectly controlled the person who committed such violation."[56] However, again, Congress limited this authority to insider trading violations, and required the SEC to go to federal court.[57]

Then, as part of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Reform Act),[58] Congress granted the SEC power to impose monetary penalties in administrative proceedings.[59] The Reform Act also gave the SEC the power to issue cease and desist orders against both registered and non-registered entities and to obtain court orders prohibiting persons who violate specific anti-fraud provisions from serving as officers and directors of reporting companies.[60] While the SEC had hoped Congress would grant it the authority to impose monetary penalties against any person or entity, regardless of its registration status, Congress refused to do so in order to

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ebeb853f0ad9/SEC_alert_021114.pdf. Monetary penalties were available in criminal proceedings. *Id.*

50 *See id.*

51 15 U.S.C. § 77h(d)–(e); Arthur F. Mathews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 CATH. U. L. REV. 215, 216–22 (1980).

52 Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (codified as amended in scattered sections of 15 U.S.C.).

53 *See* Eisenberg, *supra* note 49.

54 *Id.*

55 Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (codified as amended in scattered sections of 15 U.S.C.).

56 *See* 15 U.S.C. § 78u-1; Eisenberg, *supra* note 49.

57 *See* Eisenberg, *supra* note 49.

58 Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (codified as amended in scattered sections of 15 U.S.C.).

59 *See* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 393 (2008); Eisenberg, *supra* note 49; Jones, *supra* note 22, at 512.

60 *See* Jones, *supra* note 22, at 512.

ensure that an independent judicial check existed to restrain the Commission's enforcement power.[61] Congress was concerned that if the same remedies were available in both judicial and administrative enforcement, it might look like the SEC had an incentive to conduct more enforcement actions through its own administrative law courts, rather than in federal court.[62]

In 2002, the Sarbanes-Oxley Act (Sarbanes-Oxley)[63] further expanded the SEC's enforcement powers and increased the criminal penalties for violations of federal securities laws.[64] Prior to Sarbanes-Oxley, the SEC normally used disgorged funds to provide restitution and relief for those harmed by a defendant's wrongdoing.[65] Section 308(a) of Sarbanes-Oxley added monetary penalties, provided, however, that disgorgement[66] had also occurred.[67] However, the principal deterrent to bringing administrative proceedings against non-registered entities remained: the SEC could still only seek monetary penalties against these entities in federal court.[68]

Finally, in 2010, following a period of economic recession and political pressure to more stringently regulate financial organizations, President Barack Obama signed Dodd-Frank into law,[69] expanding the SEC's penalty authority in a number of ways.[70] Most significantly, the

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61 *See* Atkins & Bondi, *supra* note 59, at 391–93; Jones, *supra* note 22, at 512.

62 *See* Atkins & Bondi, *supra* note 59, at 393–94; Jones, *supra* note 22, at 513.

63 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

64 *See* Atkins & Bondi, *supra* note 59, at 395; Jones, *supra* note 22, at 514.

65 *See* Atkins & Bondi, *supra* note 59, at 396 ("Prior to Section 308(a), the Commission was permitted to remit amounts obtained in actions as *disgorgement* to injured investors, but was required to remit any *penalties* it received to the U.S. Treasury."); Jones, *supra* note 22, at 514.

66 "[D]isgorgement" is defined as "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion." *Disgorgement*, BLACK'S LAW DICTIONARY (10th ed. 2014).

67 *See* 15 U.S.C. § 7246(a); Atkins & Bondi, *supra* note 59, at 396; Jones, *supra* note 22, at 514.

68 *See* Jones, *supra* note 22, at 515.

69 *See* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 2, 5, 7, 11, 12, 15, 18, 22, 26, 28, 31, 42, and 44 U.S.C.); Jones, *supra* note 22, at 516.

70 *See* Jones, *supra* note 22, at 516; Platt, *supra* note 44, at 7; *The Dodd-Frank Act Reinforces and Expands SEC Enforcement Powers*, GIBSON DUNN (July 21, 2010), http://www.gibsondunn.com/Publications/Pages/Dodd-FrankActReinforcesAndExpandsSECEnforcementPowers.aspx. In addition, Dodd-Frank gave the SEC the power to impose "collateral bars," bans on involvement with the entire securities business. *See* Dodd-Frank Act § 925, 15 U.S.C. §§ 78o, 78o-4, 78q-1, 80b-3; Chad Howell, *Back to the Future: Applying the Collateral Bars of Section 925 of the Dodd-Frank Act to Previous Bad Acts*, 7 J. BUS. & TECH. L. 285, 288 (2012) ("Essentially, the Commission is now authorized to put an individual completely out of the regulated securities business, even out of areas that had nothing to do with the violation of the securities law for which the individual was charged." (footnote omitted)). Under prior law, the SEC had authority to bar a defendant from associating with the area he had previously associated with and which led to the charged misconduct—i.e., "an

SEC was finally granted the power to impose monetary penalties in its own administrative proceedings, regardless of the defendant's registration status.[71]

E. *The SEC's Increased Use of Administrative Proceedings*

In October of 2013, SEC Enforcement Director Andrew Ceresney publicly declared that the SEC would bring more administrative proceedings given Dodd-Frank.[72] Since the SEC's enforcement power was expanded by Dodd-Frank in 2010,[73] the SEC has preferred to pursue civil penalties before its ALJs, rather than in federal court.[74] This surge appears to be motivated, at least in part, by the "home court advantage" that the SEC allegedly enjoys before its ALJs.[75] The

investment adviser could be barred from associating with other investment advisers, but not with brokers, dealers, etc." *See generally* Teicher v. SEC, 177 F.3d 1016 (D.C. Cir. 1999).

71 *See* Jones, *supra* note 22, at 516; Eisenberg, *supra* note 49; *The Dodd-Frank Act Reinforces and Expands SEC Enforcement Powers*, *supra* note 70.

72 *See* Jed S. Rakoff, PLI Securities Regulation Institute Keynote Address: Is the S.E.C. Becoming a Law unto Itself? (Nov. 5, 2014). Administrative proceedings constitute more than eighty percent of the SEC's caseload. *See* Jones, *supra* note 22, at 509. On June 11, 2014, Mr. Ceresney made specific reference to insider trading cases, which previously had only rarely been brought administratively. *See* James Meyers, *SEC Gives Itself Home-Court Advantage*, LAW360 (Aug. 5, 2014, 10:15 AM), http://www.law360.com/articles/563274/sec-gives-itself-home-court-advantage; Wilczek, *supra* note 17; Potter III, *supra* note 4; Frongillo, Raphael & Simons, *supra* note 2. Also, in the fall of 2014, Kara Brockmeyer, head of the SECs anti-foreign corruption enforcement unit, stated: "It's fair to say it's the new normal. Just like the rest of the enforcement division, we're moving towards using administrative proceedings more frequently." Rakoff, *supra*.

73 *See* 15 U.S.C. § 77h-1.

74 *See* Brian E. Casey, *Insider Trading and Administrative Courts—More on Two Hot Topics that Have Now Converged*, NAT'L L. REV. (Sept. 29, 2015), http://www.natlawreview.com/article/insider-trading-and-administrative-courts-more-two-hot-topics-have-now-converged; Sara Gilley, Heather Lazur & Alberto Vargus, *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360 (May 27, 2015, 10:25 AM), http://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup (noting that prior to the passage of Dodd-Frank the SEC brought approximately sixty percent of its enforcement actions as administrative proceedings, and now brings more than eighty percent of its enforcement actions as administrative proceedings); Jody Godoy, *90% of SEC's Public Co. Enforcement In-House, Report Says*, LAW360 (May 17, 2016, 2:51 PM), http://www.law360.com/securities/articles/797160?nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities; Elizabeth P. Gray & Amelia A. Cottrell, *SEC Attempts to Address Due Process Concerns*, LAW360 (Sept. 28, 2015, 4:01 PM), http://www.law360.com/privateequity/articles/707917/sec-attempts-to-address-due-process-concerns. "In the fiscal year 2012, the Commission instituted 462 administrative proceedings; in 2013, 469; and in 2014, 616." *See* Jones, *supra* note 22, at 517 (footnotes omitted).

75 As one defendant described, "mere specter of the process renders submission from the defendant because the process is rigged against him." *See* Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 6, Peixoto v. SEC, No. 14-cv-8364 (S.D.N.Y. Oct. 20, 2014). In a "Discussion with Andrew Ceresney," moderated by Larry P. Ellsworth, Partner, Jenner & Block, to the members of the D.C. Bar in June 2014, the SEC Director of Enforcement

administrative proceedings are adjudicated by internally appointed ALJs,[76] the SEC pays the judges,[77] and the defendants are subject to appeal in the first instance to the SEC—to the same Commissioners who originally voted to authorize the enforcement action.[78]

However, it is important to note that there are some benefits to the SEC's use of its administrative law courts.[79] For instance, by using its "in house" courts, the SEC is able to rely on sophisticated and experienced fact finders to fairly resolve disputes.[80] Using administrative law courts allows the ALJs, who are deeply engrossed in the complicated area of securities law, to hear cases that the district courts are often unprepared to handle.[81] The increased use of administrative proceedings also

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stated: "I will tell you that there have been a number of cases in recent months where we have threatened administrative proceedings, it was something we told the other side we were going to do and they settled." *See* Brian Mahoney, *SEC Could Bring More Insider Trading Cases In-House*, LAW360 (June 11, 2014, 6:53 PM), http://www.law360.com/articles/547183/sec-could-bring-more-insider-trading-cases-in-house; *see also* Jean Eaglesham, *SEC Wins with In-House Judges*, WALL STREET J. (May 6, 2015, 10:30 PM), http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803 (Joseph Grundfest, a former SEC Commissioner who is now a law professor at Stanford University said: "By bringing more cases in its own backyard, the agency is not only increasing its chances of winning but giving itself greater control over the future evolution of legal doctrine."); Jean Eaglesham, *SEC Gives Ground on Judges*, WALL STREET J. (Sept. 24, 2015, 8:03 PM), http://www.wsj.com/article_email/sec-gives-ground-on-judges-1443139425-lMyQjAxMTE1NDI3NTAyNjU5Wj ("Going back to October 2004, the SEC has won against at least four of five defendants in front of its own judges every fiscal year."); Derrelle M. Janey & Robert C. Gottlieb, *The Odds Are Stacked Against Insider Trading Defendants*, LAW360 (Mar. 30, 2015, 2:25 PM), http://www.law360.com/articles/637172/the-odds-are-stacked-against-insider-trading-defendants; Susan D. Resley et al., *Dealing with the SEC's Administrative Proceeding Trend*, LAW360 (Jan. 13, 2015, 5:10 PM), http://www.law360.com/articles/610688/dealing-with-the-sec-s-administrative-proceeding-trend; *infra* note 84.

76 *See* Hardy, Kendall & Rein, *supra* note 7; Spunaugle, *supra* note 2; discussion *infra* Section II.C.

77 *See* 5 U.S.C. § 5372; Eaglesham, *supra* note 75 (quoting J. Jed Rakoff); Hardy, Kendall & Rein, *supra* note 7.

78 *See* SEC Rules of Practice, 17 C.F.R. § 201.410(a) (2016); *see also* Marc J. Fagel, *The State of SEC Enforcement Heading into 2015*, 29 INSIGHTS: CORP. & SEC. L. ADVISOR 1, 2 (Feb. 2015), http://www.gibsondunn.com/publications/Documents/Fagel-State-of-SEC-Enforcement-Insights-2.2015.pdf.

79 *But see* Kent Barnett, *Against Administrative Judges*, 49 U.C. DAVIS L. REV. 1643 (2016); Spunaugle, *supra* note 2, at 406–07 (identifying these potential advantages and then arguing that there are alternative explanations that may more accurately reflect the SEC's motivations).

80 Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, WALL STREET J. (Oct. 21, 2014, 9:40 AM), http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590. Andrew Ceresney has posited that the SEC "isn't trying to sidestep the federal court system for difficult cases," and has explained that "[the agency is] using administrative proceedings more extensively because they offer a streamlined process with sophisticated fact finders." *Id.*; *see also* Spunaugle, *supra* note 2, at 411.

81 *See* Spunaugle, *supra* note 2, at 411; Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. TIMES (Oct. 5, 2013), http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html? _r=0 (quoting George Canellos, former co-director of enforcement at the SEC).

reduces the burdensome caseload on the district courts, potentially affording a benefit for the entire legal system.[82] In fact, by utilizing its administrative law courts, the SEC reasons that it will be able to more efficiently resolve disputes, since their administrative dockets move much faster than the district courts.[83] Thus, the desire for expertise and efficiency may be a more accurate reflection of the SEC's motivation to increasingly use its administrative forum.

Regardless of the SEC's motivations, since Dodd-Frank was passed in 2010, the SEC's success rate in administrative proceedings has ranged from ninety to 100 percent.[84] In the federal courts, however, the Commission's five-year record is only sixty-nine percent.[85] Frustrated with this apparent injustice, an increasing number of defendants have filed suit to enjoin the SEC from bringing its administrative proceedings and to require the SEC to litigate in federal court, alleging three constitutional deficiencies with the administrative proceedings and the ALJs who adjudicate them.[86]

II. ALLEGED CONSTITUTIONAL DEFICIENCIES WITH THE SEC'S ADMINISTRATIVE PROCEEDINGS

A. *The SEC's Administrative Proceedings Are a Violation of Due Process and the Seventh Amendment*

On March 1, 2011, in its first use of its new Dodd-Frank administrative reach, the SEC brought an administrative cease and

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82 *See* Andrew Ceresney, Director, SEC Div. of Enf't, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#.VNBim0fF_iM; *see also* Spunaugle, *supra* note 2, at 411.

83 *See* Eaglesham, *supra* note 80; Mahoney, *supra* note 75; *see also* Spunaugle, *supra* note 2, at 411.

84 "The SEC's success rate in administrative proceedings over the past five years has been 90 percent and in the fiscal year ended Sept. 30, 2014, it was a perfect 100 percent." Thomas A. Hanusik et al., *What's Missing from the SEC's Forum Selection Guidance*, LAW360 (May 21, 2015, 10:34 AM), http://www.law360.com/articles/658532/what-s-missing-from-the-sec-s-forum-selection-guidance; *see also* Bondi et al., *supra* note 44; Hardy, Kendall & Rein, *supra* note 7; Thomas Zaccaro, Nicolas Morgan & Peter T. Brejcha, *Is SEC's Home Court Advantage Legal?*, L.A. DAILY J. (Aug. 13, 2015), http://www.zaccaromorgan.com/wp-content/uploads/2015/08/Zaccaro-Morgan-article-by-Tom-813151.pdf.

85 *See* Hanusik et al., *supra* note 84. According to Jed S. Rakoff, United States District Judge for the Southern District of New York, "the commission's choice of forum [i]s designed to gain an unfair advantage by depriving [defendants] of the protections [they] would have had if the case were brought in federal court." *See* Meyers, *supra* note 72.

86 *See* Hardy, Kendall & Rein, *supra* note 7; discussion *infra* Part II.

desist proceeding against Rajat K. Gupta[87] for insider trading, seeking civil penalties, disgorgement, and various forms of injunctive relief.[88] Gupta challenged the SEC's decision to proceed administratively by filing a collateral action in the Southern District of New York, alleging multiple violations of due process and other constitutional protections, including his Seventh Amendment right to a trial by jury.[89] However, because the SEC subsequently dismissed the administrative proceeding, the District Court was not able to decide the case on its merits.[90] Since then, a number of defendants have challenged the SEC's use of administrative proceedings, raising concerns with the lack of due process and concern for the rights afforded by the Seventh Amendment in the SEC's administrative law courts.[91] The administrative law courts provide significantly fewer procedural protections for defendants than federal courts, including, inter alia, the right to a trial by jury, the right to immediate appellate review to a neutral arbitrator, the right to discovery, and the right to have the proceedings bound by the Federal Rules of Evidence.[92] However, with regard to the SEC's administrative

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87 Rajat K. Gupta, the former director of Goldman Sachs Group Inc. and managing partner of the consulting firm McKinsey & Company, was ultimately convicted of insider trading and served a two-year prison term for leaking tips to "hedge fund billionaire" Raj Rajaratnam. *See* Patricia Hurtado, *Ex-Goldman Director Rajat Gupta Back Home After Prison Stay*, BLOOMBERG (Jan. 19, 2016, 3:29 PM), http://www.bloomberg.com/news/articles/2016-01-19/ex-goldman-director-rajat-gupta-back-home-after-prison-stay.

88 Rajat K. Gupta, Securities Act Release No. 9192, Exchange Act Release No. 63995, Investment Advisers Act Release No. 3167, Investment Company Act Release No. 29590 (Mar. 1, 2011) (order instituting public administrative and cease-and-desist proceedings).

89 *See* U.S. CONST. amend. VII; Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

90 Rajat K. Gupta, Securities Act Release No. 9249, Exchange Act Release No. 65037, Investment Advisers Act Release No. 3259, Investment Company Act Release No. 29745 (Aug. 4, 2011) (order dismissing proceedings); Elaine Greenberg et al., *SEC Reloads Its Quiver with Administrative Proceedings*, LAW360 (Dec. 23, 2014, 11:41 AM), http://www.law360.com/articles/604814/sec-reloads-its-quiver-with-administrative-proceedings; Peter Lattman, *S.E.C. Drops Proceeding Against Rajat Gupta*, N.Y. TIMES: DEALBOOK (Aug. 4, 2011, 8:26 PM), http://dealbook.nytimes.com/2011/08/04/s-e-c-drops-administrative-proceeding-against-gupta/?_r=0.

91 *See, e.g.*, Bebo v. SEC, No. 15-C-3, 2015 U.S. Dist. LEXIS 25660 (E.D. Wis. Mar. 3, 2015) (dismissed for lack of subject matter jurisdiction); Chau v. SEC, 72 F. Supp. 3d 417 (S.D.N.Y. 2014) (dismissed for lack of subject matter jurisdiction), *aff'd*, No 15-461-CV, 2016 WL 7036830 (2d Cir. Dec. 2, 2016); Altman v. SEC, 768 F. Supp. 2d 554 (S.D.N.Y. 2011) (dismissed for lack of subject matter jurisdiction), *aff'd*, 687 F.3d 44 (2d Cir. 2012). *See generally* Platt, *supra* note 44, at 12–14 (tables listing cases).

92 *See, e.g.*, *Chau*, 72 F. Supp. 3d 417; Jarkesy v. SEC, 48 F. Supp. 3d 32 (D.D.C. 2014), *aff'd*, 803 F.3d 9 (D.C. Cir. 2015). Although *Chau* was dismissed for lack of subject matter jurisdiction, J. Lewis A. Kaplan acknowledged that the constitutional concerns that are troublesome to many are "legitimate." *See* Greenberg et al., *supra* note 90; *see also* Spunaugle, *supra* note 2, at 406–10; Jared P. Cole, *Appointment of SEC ALJ is Unconstitutional, Rules Federal District Court*, PENNY HILL PRESS (July 16, 2015), http://pennyhill.com/jmsfileseller/docs/NB201507014.pdf [http://web.archive.org/web/20160702121213/http://pennyhill.com/

proceedings, no court has ruled on the merits of this issue because these cases have all been either voluntarily dismissed or dismissed for lack of subject matter jurisdiction.[93] Although, with respect to other administrative agencies, these due process and Seventh Amendment arguments have all been rejected by the courts, including the Supreme Court of the United States.[94]

In addition to being denied the right to a trial by jury[95] and having the proceedings be adjudicated by an ALJ, who acts as both the finder of fact and law,[96] the expedited nature of the SEC's administrative proceedings—the "rocket docket"[97]—is generally disadvantageous for defendants, who do not have as much time as the SEC to develop a complete record.[98] Although the SEC's Rules of Practice (ROP) have since been amended, an administrative proceeding was previously not permitted to last more than four months, and the SEC, at its discretion, could shorten this time span to just one month.[99] Discovery in administrative proceedings was—and still is—extremely limited.[100] A defendant is not entitled to documents in the SEC investigation file that disclose the identity of a confidential source and are privileged.[101] Defendants were also not entitled to take depositions.[102] In addition, the SEC's administrative proceedings are governed by the ROP, rather than

jmsfileseller/docs/NB201507014.pdf]; Frongillo, Raphael & Simons, *supra* note 2; Hanusik et al., *supra* note 84.

93 *See supra* note 91.

94 *See, e.g.*, Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n, 430 U.S. 442 (1977) (jury); Crowell v. Benson, 285 U.S. 22 (1932) (due process).

95 *See* Gupta v. SEC, 796 F. Supp. 2d 503, 508 (S.D.N.Y. 2011); Glassman, *supra* note 3, at 52; Hardy, Kendall & Rein, *supra* note 7.

96 *See* Glassman, *supra* note 3, at 52; Hardy, Kendall & Rein, *supra* note 7.

97 *See* 15 U.S.C. § 78y(b)(4) (2012); Claudius O. Sokenu et al., *Securities Enforcement 2014 Year-End Review*, SHEARMAN & STERLING L.L.P. (Jan. 2015), http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/01/Securities-Enforcement-2014-Year-End-Review-LT-012915.pdf, 4; Spunaugle, *supra* note 2, at 409; Meyers, *supra* note 72.

98 *See* Hardy, Kendall & Rein, *supra* note 7; Winer & Kwaterski, *supra* note 29.

99 *See* 17 C.F.R. § 201.360(a)(2) (2016) ("In the Commission's discretion, after consideration of the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors, [the time period in which the hearing officer's initial decision must be filed with the Secretary] will be either 120, 210, or 300 days from the date of service of the order. Under the 300-day timeline, the hearing officer shall issue an order providing that there shall be approximately 4 months from the order instituting the proceeding to the hearing. . . . Under the 120-day timeline, the hearing officer shall issue an order providing that there shall be approximately 1 month from the order instituting the proceeding to the hearing."); Hardy, Kendall & Rein, *supra* note 7.

100 *See* Hardy, Kendall & Rein, *supra* note 7; Winer & Kwaterski, *supra* note 29.

101 *See* 17 C.F.R. § 201.230; Hardy, Kendall & Rein, *supra* note 7.

102 *See* Hardy, Kendall & Rein, *supra* note 7. This provision of the ROP has since been amended to "[a]llow parties in the cases designated for the longest timelines the right to notice three depositions per side in single-respondent cases and five depositions per side in multi-respondent cases, and to request an additional two depositions." *See* Press Release, *infra* note 111.

the Federal Rules of Evidence.[103] The ROP are considerably more lax than the Federal Rules of Evidence,[104] and thus traditionally inadmissible evidence, such as hearsay,[105] is regularly considered.[106]

Besides being criticized by scholars and defendants,[107] the SEC's practices have also been criticized from within. For example, Anne K. Small, the SEC's General Counsel, acknowledged that it is "entirely reasonable" for attorneys to question whether the SEC's rules for such proceedings are outdated and should be revised.[108] Michael Piwowar, a Commissioner, also expressed his opinion that the SEC's "enforcement program could also benefit from a look through the lens of fairness."[109] In the face of criticism and legal claims, the SEC proposed for comment amendments to its ROP, with the stated objective of giving defendants more of the legal protections available in federal court.[110] After consideration of the comments received, the SEC adopted final amendments that, among other things, give defendants ten, rather than four, months to prepare for trial, and allow defendants to take a limited number of depositions.[111] However, because the proposed amendment does not address many of the core issues, such as changing the SEC's

103 *See* Spunaugle, *supra* note 2, at 406–07; Hanusik et al., *supra* note 84; Hardy, Kendall & Rein, *supra* note 7; Stephanie Russell-Kraft, *Rakoff Hopes SEC Will 'Think Twice' About Using Admin Court*, LAW360 (Mar. 3, 2015, 4:42 PM), http://www.law360.com/articles/627028t; Stephanie Russell-Kraft, *Rakoff Continues Crusade Against SEC Admin Courts*, LAW360 (Nov. 21, 2014, 1:46 PM), http://www.law360.com/articles/598561/rakoff-continues-crusade-against-sec-admin-courts.

104 *See* Cole, *supra* note 92.

105 *See* Spunaugle, *supra* note 2; Janey & Gottlieb, *supra* note 75; Russell-Kraft, *Rakoff Hopes SEC Will 'Think Twice' About Using Admin Court*, *supra* note 103.

106 *See* Hardy, Kendall & Rein, *supra* note 7.

107 *See* discussion *supra* notes 96–06 and accompanying text.

108 *See* Frongillo, Raphael & Simons, *supra* note 2; Daniel Wilson, *SEC Administrative Case Rules Likely Out of Date, GC Says*, LAW360 (June 17, 2014, 5:55 PM), http://www.law360.com/articles/548907/sec-administrative-case-rules-likely-out-of-date-gc-says.

109 *See* Michael S. Piwowar, Comm'r, SEC, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly, and Efficient SEC (Feb. 20, 2015); Janey & Gottlieb, *supra* note 75.

110 Amendments to the Commission's Rules of Practice, Release No. 34-75977 (proposed Sept. 24, 2015) (to be codified at 17 C.F.R. pt. 201); Ed Beeson, *SEC Court to Get Face-Lift, But Attys Still See the Wrinkles*, LAW360 (Sept. 25, 2015, 9:24 PM), http://www.law360.com/articles/707467/sec-court-to-get-face-lift-but-attys-still-see-the-wrinkles; Peter K.M. Chan et al., *Tweaking the "Home Court" Rules for SEC Administrative Proceedings*, MORGAN LEWIS (Sept. 28, 2015), http://www.morganlewis.com/pubs/tweaking-the-home-court-rules-for-sec-administrative-proceedings; Eaglesham, *SEC Gives Ground on Judges*, *supra* note 75; Gray & Cottrell, *supra* note 74.

111 *See* Press Release, SEC, SEC Adopts Amendments to Rules of Practice for Administrative Proceedings (July 13, 2016), https://www.sec.gov/news/pressrelease/2016-142.html; Carmen Germaine, *SEC Faces Long Road Ahead on Admin Court Reforms*, LAW360 (July 13, 2016, 9:54 PM), http://www.law360.com/securities/articles/816979?nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities.

role as both the prosecutor and adjudicator,[112] critics say that these changes do not go far enough.[113]

B. *The SEC's Removal Scheme Is a Violation of Article II*

Critics have also contended that the SEC's removal scheme violates the Take Care Clause of the Constitution because the ALJs enjoy multiple layers of tenure protection.[114] The clause provides that the President must "take Care that the Laws be faithfully executed."[115] However, in light of "[t]he impossibility that one man should be able to perform all the great business of the State,"[116] the Constitution provides for the appointment of executive officers[117] to "assist the supreme Magistrate in discharging the duties of his trust."[118] The drafters of the Constitution recognized that the President must have the power to

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112 Joseph Quincy Patterson, Note, *Many Key Issues Still Left Unaddressed in the Securities and Exchange Commission's Attempt to Modernize Its Rules of Practice*, 91 NOTRE DAME L. REV. 1675 (2016); Peter K.M. Chan et al., *Morgan Lewis Discusses Tweaking the "Home Court" Rules for SEC Administrative Proceedings*, CLS BLUE SKY BLOG (Oct. 14, 2015), http://clsbluesky.law.columbia.edu/2015/10/14/morgan-lewis-discusses-tweaking-the-home-court-rules-for-sec-administrative-proceedings.

113 *See* Eaglesham, *SEC Gives Ground on Judges*, *supra* note 75; Joan E. McKown et al., *SEC Publishes Final Rules Amending the Rules of Practice for Administrative Proceedings*, JONES DAY (July 2016), http://www.jonesday.com/sec-publishes-final-rules-amending-the-rules-of-practice-for-administrative-proceedings-07-19-2016. Defendants subjected to an administrative proceeding will only be able to depose up to five people. Eaglesham, *supra*. Joel Cohen, a partner at Gibson Dunn who successfully defended Nelson Obus in 2014 on charges of insider trading, said that had he been limited by the new SEC rules for its administrative law courts "I seriously doubt we would have been able to develop the facts that convinced the jury to find in our favor. . . . [The proposals] do not go far enough." *Id.* Susan Resley, chair of the securities enforcement practice at Morgan Lewis & Bockius L.L.P., said that "[g]iving three to five deposition slots really can only help the [SEC] expand its own record after it starts a case." Beeson, *supra* note 110. "These changes, if implemented, would still allow the SEC to bury someone in documents and force them to go to trial unprepared," said Alex Lipman, a partner at Brown Rudnick L.L.P., who currently represents Chau in his fight with the SEC over the constitutionality of its administrative law courts. *Id.* Terry Weiss, an attorney for Greenberg Taurig L.L.P., who represents Gray, noted that "[a]lthough the SEC may now recognize that its home court judiciary has serious failings, the proposed few changes are no more than drops of water on an inferno" and that the administrative "process needs a major overhaul." *Id.*; *see also* Burke et al., *supra* note 110.

114 *See* Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial, Stilwell v. SEC (S.D.N.Y. 2014) (No. 14-CV-7931). *See generally* Free Enter. Fund v. Pub. Co. Accounting Oversight Bd. (*PCAOB*), 561 U.S. 477 (2010).

115 U.S. CONST. art. II, § 3, cl. 5.

116 GEORGE WASHINGTON, THE WRITINGS OF GEORGE WASHINGTON FROM THE ORIGINAL MANUSCRIPT SOURCES 1745–1799 VOLUME 30: JUNE 20, 1788–JANUARY 21, 1790, 334 (J. Fitzpatrick ed., 1939) (1788), *quoted in PCAOB*, 561 U.S. at 483.

117 *See* U.S. CONST art. II, § 2, cl. 2.

118 *See* GEORGE WASHINGTON, *supra* note 116, at 334, *quoted in PCAOB*, 561 U.S. at 483.

remove executive officers in order to keep them accountable.[119] In the case of *Free Enterprise Fund v. Public Company Accounting Oversight Board* (*PCAOB*),[120] the Supreme Court held that, while this removal power is not without limit,[121] an executive officer may not be separated from presidential supervision by more than one layer of tenure protection.[122]

In *PCAOB*, the Supreme Court was asked to decide whether the removal scheme of the Public Company Accounting Oversight Board (PCAOB), composed of five members appointed by the SEC, contravened the Constitution's vesting of the executive power in the President by insulating the Board members from Presidential control by two layers of tenure protection.[123] Writing for the Court, Chief Justice Roberts explained that because the SEC could not remove the Board members at will, but only for good cause,[124] and because the Commissioners, in turn, could not be removed by the President except for "inefficiency, neglect of duty, or malfeasance in office,"[125] such an attenuated removal scheme violated Article II of the Constitution.[126]

Like the Board in *PCAOB*, the SEC's ALJs are also separated from presidential supervision by multiple levels of tenure protection.[127] First, the SEC's ALJs are protected by statute from removal absent "good cause."[128] Second, the Commissioners, who exercise the power of removal,[129] are themselves protected from removal by the President

119 *See generally* Myers v. United States, 272 U.S. 52 (1926), *overruled by PCAOB*, 561 U.S. 477; *see also* LETTER FROM JAMES MADISON TO THOMAS JEFFERSON (JUNE 30, 1789), THE DOCUMENTARY HISTORY OF THE FIRST FEDERAL CONGRESS OF THE UNITED STATES OF AMERICA, MARCH 4, 1789–MARCH 3, 1791, VOL. 16 CORRESPONDENCE: FIRST SESSION JUNE-AUGUST 1789, at 893 (Charlene Bangs Bickford et al. eds., 2004).

120 *PCAOB*, 561 U.S. 477.

121 *See* Humphrey's Ex'r v. United States, 295 U.S. 602 (1935) (holding that depending on the nature of the agency, the President's power can be limited to removal for good cause, such as "inefficiency, neglect of duty, or malfeasance in office").

122 *See PCAOB*, 561 U.S. at 484.

123 The PCAOB was created as part of a series of accounting reforms in the Sarbanes-Oxley Act of 2002. *See PCAOB*, 561 U.S. at 484–85.

124 *See* 15 U.S.C. § 7211(e)(6) (2012); *id.* § 7217(d)(3); *PCAOB*, 561 U.S. at 486.

125 *PCAOB*, 561 U.S. at 487 (quoting *Humphrey's Ex'r*, 295 U.S. at 620 (setting forth the standard for "for-cause" removal)).

126 *See PCAOB*, 561 U.S. at 496–97 ("Without the ability to oversee the Board, or to attribute the Board's failings to those whom he can oversee, the President is no longer the judge of . . . whether Board members are abusing their offices or neglecting their duties. . . . [Nor can he] ensure that the laws are faithfully executed.").

127 The SEC's ALJs are inferior officers. *See* discussion *infra* Section II.C. *See generally PCAOB*, 561 U.S. 477.

128 *See* 5 U.S.C. § 7521(a); *see also* Complaint for Declaratory and Injunctive Relief at 11, Duka v. SEC, 103 F. Supp. 3d 382 (S.D.N.Y. 2015) (No. 15-CV-357), *abrogated by* Tilton v. SEC, 824 F.3d 276 (2016); Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial, Stilwell v. SEC (S.D.N.Y. 2014) (No. 14-CV-7931).

129 *See* 5 U.S.C. § 7521(a).

except for "inefficiency, neglect of duty, or malfeasance in office."[130] Third, members of the Merit Systems Protection Board (MSPB),[131] who determine whether sufficient "good cause" exists to remove an SEC ALJ, also cannot be removed by the President except for "inefficiency, neglect of duty, or malfeasance in office."[132]

In *Duka v. SEC*, Duka argued that this attenuated removal scheme is unconstitutional because the President cannot remove an SEC ALJ even if the President determines that the officer is neglecting his duties or discharging them improperly.[133] The district court disagreed.[134] In the court's opinion, *PCAOB* did not create a "categorical rule forbidding two levels of 'good-cause' tenure protection."[135] Rather, the principal issue for the Supreme Court was whether the PCAOB's removal scheme was so structured as to infringe on the President's duty to ensure that the laws are faithfully executed.[136] Such a determination turns on the "nature of the function that Congress vested in the [executive officer]."[137]

Constraints on the removal of agency adjudicators, as opposed to agency officials with wholly executive functions, generally do not violate Article II.[138] For example, in *Humphrey's Executor v. United States*,[139] the Supreme Court upheld the constitutionality of a statute forbidding the President from removing commissioners of the Federal Trade Commission (FTC) except for good cause.[140] Justice Sutherland's analysis in that case turned on the fact that the function of the FTC is not "purely executive."[141] Rather, the FTC is an independent agency that

130 *See PCAOB*, 561 U.S. 477; Complaint for Declaratory and Injunctive Relief at 11, *Duka*, 103 F. Supp. 3d 382 (No. 15-CV-357) (quoting *PCAOB*, 561 U.S. at 487).

131 The MSPB is "an independent, quasi-judicial agency in the Executive branch that serves as the guardian of Federal merit systems." For more information regarding the MSPB, see *About MSPB*, U.S. MERIT SYS. PROTECTION BOARD, http://www.mspb.gov/About/about.htm (last visited Dec. 29, 2015).

132 *See* 5 U.S.C. § 1202(d); Complaint for Declaratory and Injunctive Relief at 11, *Duka*, 103 F. Supp. 3d 382 (No. 15-CV-357) (quoting 5 U.S.C. § 1202(d)).

133 *See generally PCAOB*, 561 U.S. 477. *See* Complaint for Declaratory and Injunctive Relief at 12–13, *Duka*, 103 F. Supp. 3d 382 (No. 15-CV-357).

134 *See Duka*, 103 F. Supp. 3d at 393.

135 *Id.*; *see also PCAOB*, 561 U.S. at 536 (Breyer, J. dissenting).

136 *See Duka*, 103 F. Supp. 3d at 393–96.

137 *See id.* at 394 (quoting Wiener v. United States, 357 U.S. 349, 353 (1958)).

138 *See id.* at 395; *see also Wiener*, 357 U.S. at 354–56 (upholding restrictions upon the President's power to remove members of the War Claims Commission on the grounds that the commission was established as an "adjudicating body" and was meant to be "entirely free from the control or coercive influence, direct or indirect, of either the Executive or the Congress." (citation omitted)).

139 *See* Humphrey's Ex'r v. United States, 295 U.S. 602 (1935).

140 *See id.* at 627–29.

141 *See id.* at 628–29.

is granted "quasi judicial" and "quasi legislative" power, and therefore cannot be considered an "arm . . . of the executive."[142]

Relying on the *Humphrey's Executor* standard, the *Duka* court reasoned that since the SEC's ALJs only perform "adjudicatory functions, and are not engaged in policymaking or enforcement," [143] the President's discretion to remove an ALJ is not so fundamental to the functioning of the Executive Branch as to require, as a matter of constitutional law, that the ALJ be terminable at will by the President.[144] Finding no other basis for concluding that the statutory restrictions for removal of SEC ALJs are so structured as to encroach on the President's constitutional authority, the court held that Duka failed to demonstrate a likelihood of success on the merits of her claim that the SEC's removal scheme violated the Constitution.[145]

C. *The SEC's Appointment Scheme Is a Violation of the Appointments Clause*

Defendants have also argued that the SEC's procedure for appointing ALJs violates the Constitution's Appointments Clause because the ALJs are not appointed directly by the SEC's Commissioners, but by the SEC's Office of Administrative Law Judges, with input from the Chief Administrative Law Judge, human resources, and the OPM.[146] The Appointments Clause[147] creates two classes of

142 *See id.* at 628; *Duka*, 103 F. Supp. 3d at 394.

143 *See Duka*, 103 F. Supp. 3d at 395.

144 *See id.* at 395–96. For-cause protection for adjudicators is appropriate. *See* Wiener v. United States, 357 U.S. 349, 356 (1958). In fact, in *Myers v. United States*, the Court suggested that the President has to leave adjudicators alone. *See generally* Myers v. United States, 272 U.S. 52 (1926), *overruled by PCAOB*, 561 U.S. 477 (2010).

145 *See Duka*, 103 F. Supp. 3d at 395–96. Likewise, in *Hill v. SEC*, 114 F. Supp. 3d 1297 (N.D. Ga. 2015), *vacated on other grounds and remanded*, 825 F.3d 1236 (11th Cir. 2016), the U.S. District Court for the Northern District of Georgia was called upon to determine whether the SEC's ALJ's multi-layer tenure protections violated Article II's removal protections. The *Hill* court had serious doubts that the SEC's removal scheme violated the Constitution because the ALJs do not occupy a wholly executive position, and thus the multi-layer tenure protections do not interfere with the President's ability to perform his constitutional responsibilities. *Id.* at 1319 n.12. However, because the court found that the defendant's other constitutional claim established a likelihood of success on the merits, the court declined to address the defendant's contention that the SEC's removal scheme violated the Constitution. *Id.*; *see also* Gray Fin. Grp., Inc. v. SEC, 166 F. Supp. 3d 1335, 1354 n.10 (N.D. Ga. 2015) (holding the same as *Hill*); *vacated and remanded*, *Hill*, 825 F.3d 1236.

146 *See Hill*, 114 F. Supp. 3d 1297; Duka v. SEC, 124 F. Supp. 3d 287 (S.D.N.Y. 2015), *vacated and remanded*, No. 15-2732 (2d Cir. June 13, 2016); *Gray Fin. Grp., Inc.*, 166 F. Supp. 3d 1335; Complaint for Declaratory and Injunctive Relief and Demand for Jury Trial at 16–18, Tilton v. SEC (S.D.N.Y. June 30, 2015) (No. 15-CV-2472), 2015 U.S. District LEXIS 85015 (dismissing the case for lack of subject matter jurisdiction, but the Second Circuit has currently stayed the SEC's administrative proceeding pending the court's resolution of the jurisdictional and Article

officers: principal officers, who must be nominated and appointed by the President himself with the advice and consent of the Senate, and inferior officers, who may be appointed either by the President alone, by the Courts of Law, or by the Heads of Departments, without Senate advice and consent.[148] The appointment of subordinate officials and other employees are not subject to these constitutional requirements.[149]

The SEC's ALJs are obviously not appointed in a manner consistent with the Appointments Clause. The question is whether the clause applies. That depends on whether ALJs are "officers" or mere employees, which in turn depends on the nature and extent of their authority.[150] In *Buckley v. Valeo*, the Supreme Court held that "any appointee exercising significant authority" is an "officer" and must, therefore, be appointed according to the procedures set forth in Article II.[151]

In *Freytag v. Commissioner*,[152] the Supreme Court was asked to decide whether a Special Trial Judge (STJ) of the U.S. Tax Court was an inferior officer, and if so, whether it was a violation of the Appointments Clause for Congress to vest the power of appointing STJs in the Chief Tax Judge (CTJ).[153] The agency argued that because the STGs could not render a final decision,[154] and served merely as an aide to the CTJ, the

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II claims); Bebo v. SEC, No. 15-C-3, 2015, U.S. Dist. LEXIS 25660, at *3 (D. Wisc. Mar. 3, 2015), *aff'd*, 799 F.3d 765 (7th Cir. 2015) (no jurisdiction, but likelihood of success on the merits); Timbervest, L.L.C. v. SEC, No. 1:15-CV-2106-LMM, 2015 U.S. Dist. LEXIS 132082 (N.D. Ga. Aug. 4, 2015) (finding that the SEC's appointment scheme was likely unconstitutional, but refusing to preliminarily enjoin the SEC from publishing its decision and from enforcing its decision until a final order is issued because the defendants had appealed to the court after ALJ Cameron Elliot had rendered his initial decision); *see also* Smith, *supra* note 44; Bondi et al., *supra* note 44.

147 Article II, Section 2 provides that the President

> shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law 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.

U.S. CONST. art. II, § 2, cl. 2.

148 *See id.*; Buckley v. Valeo, 424 U.S. 1, 126 n. 162 (1976); *Hill*, 114 F. Supp. 3d at 1316; Cole, *supra* note 92.

149 *See Buckley*, 424 U.S. at 126 n. 162; Cole, *supra* note 92; Hardy, Kendall & Rein, *supra* note 7.

150 *See Hill*, 114 F. Supp. 3d at 1316–17. *See generally* Freytag v. Comm'r, 501 U.S. 868 (1991); Hardy, Kendall & Rein, *supra* note 7.

151 *See Buckley*, 424 U.S. at 126 ("[A]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States,' and must, therefore, be appointed in the manner prescribed by [Article II]."); Barnett, *supra* note 33, at 809.

152 *Freytag*, 501 U.S. 868.

153 *Id.* at 870; *see* 26 U.S.C. § 7443A(a) (2012).

154 *See* 26 U.S.C. § 7443A(c).

STJs were regular employees who were not bound by the requirements of the Appointments Clause.[155] The Court, however, disagreed.[156] Although the STJs could not render final decisions at all times,[157] they were nevertheless officers because the office of special trial judge is "established by law," and the "duties, salary, and means of appointment for that office are specified by statute."[158] The Court also noted that the STJs performed more than ministerial tasks, such as taking testimony, conducting trials, and ruling on the admissibility of evidence, in the course of which the STJs exercise significant discretion.[159] The question then became whether it was a violation of the Appointments Clause for Congress to vest the power of appointment of these officers in the Chief Tax Judge.[160] The Court held that it was not because the U.S. Tax Court was a "Court of Law" for the purposes of Article II.[161]

At first blush, *Freytag* suggests that ALJs, too, are officers of the United States. However, in *Landry v. FDIC*,[162] the U.S. Court of Appeals for the District of Columbia Circuit found the fact that STJs could render a final decision in certain cases critical to the *Freytag* Court's determination that the STJs were inferior officers.[163] In *Landry*, the court was asked to determine whether the Federal Deposit Insurance Corporation's (FDIC) method of appointing its ALJs violated the Appointments Clause.[164] Landry argued that the ALJs were inferior

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155 *See Freytag*, 501 U.S. at 880–82.

156 *Id.*

157 *See id.* at 873 ("Section 7443A(b) of the Internal Revenue Code specifically authorizes the Chief Judge of the Tax Court to assign four categories of cases to special trial judges: '(1) any declaratory judgment proceeding,' '(2) any proceeding under section 7463,' '(3) any proceeding' in which the deficiency or claimed overpayment does not exceed $10,000, and '(4) any other proceeding which the Chief Judge may designate.' In the first three categories, the Chief Judge may assign the special trial judge not only to hear and report on a case but also to decide it. [26 U.S.C.A.] § 7443A(c). In the fourth category, the chief judge may authorize the special trial judge only to hear the case and prepare proposed findings and an opinion. The actual decision then is rendered by a regular judge of the Tax Court.").

158 *See* 26 U.S.C. § 7443A; *Freytag*, 501 U.S. at 881; *see also* Samuels, Kramer & Co. v. Comm'r, 930 F.2d 975, 985 (2d Cir. 1991); First W. Gov't Sec., Inc. v. Comm'r, 94 T.C. 549, 557–59 (1990).

159 *See Freytag*, 501 U.S. at 881–82.

160 *Id.*

161 *See id.* at 888–91. Justice Blackmun saw no reason to narrowly construe the phrase "Courts of Law" to mean an Article III court, and thus concluded that "an Article I court, which exercises judicial power, can be a 'Cour[t] of Law' within the meaning of the Appointments Clause." *Id.* Writing for himself and three others, Justice Scalia agreed that a STJ is an officer, but not that the Tax Court is a "Cour[t] of Law." *Id.* at 901 (Scalia, J., concurring). He considered the arrangement constitutional because the Tax Court is a "Departmen[t]," and the Chief Tax Judge is its "head." *Id.*

162 Landry v. FDIC, 204 F.3d 1125 (D.C. Cir. 2000), *cert. denied*, No. 99-1916, 2000 U.S. LEXIS 6606 (2000).

163 *Id.* at 1133–34; *see also* Smith, *supra* note 44.

164 *See Landry*, 204 F.3d at 1128.

officers, and thus their appointment by the FDIC was unconstitutional because the FDIC is not a "department."[165] A divided court held that these ALJs were not inferior officers.[166] Although the position of the FDIC's ALJs was "established by law,"[167] as were its "duties, salary, and means of appointment,"[168] the key factor was that they did not have the ability to render a final decision.[169] In his concurring opinion, Judge Randolph rejected the majority's reasoning. Randolph asserted that there were no pertinent differences between the FDIC's ALJs and the STJs in *Freytag*,[170] and that the majority had relied on dicta that appeared in the *Freytag* opinion after the Court had already concluded that the STJs were inferior officers.[171]

Relying on the *Freytag* test,[172] the U.S. District Court for the Northern District of Georgia in *Hill v. SEC* held that the SEC's ALJs are in fact inferior officers.[173] The court based its conclusion on the fact that, like the STJs in *Freytag*, the SEC's ALJs exercise significant authority,[174] the office of SEC ALJs is "established by law,"[175] and the "duties, salary, and means of appointment" for that office are "specified by statute."[176] SEC ALJs have the power, *inter alia*, to take testimony,

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165 *See id.* at 1130.

166 *Id.* at 1133–34.

167 12 U.S.C. § 1818(e)(4) (2012).

168 5 U.S.C. §§ 556, 557 (duties); 5 U.S.C. § 5372 (salary); *id.* § 3105 (means of appointment); *Landry*, 204 F.3d at 1133–34; 12 C.F.R. § 308.5 (2016) (duties). Like the STJs in *Freytag*, the FDIC's ALJs also "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders." *Landry*, 204 F.3d at 1133–34; *see also* Freytag v. Comm'r, 501 U.S. 868, 881–82 (1991).

169 *See Landry*, 204 F.3d at 1133–34; 12 C.F.R. § 308.40(a), (c).

170 *See Landry*, 204 F.3d at 1140–41 (Randolph, J., concurring).

171 *See id.* at 1142; Hill v. SEC, 114 F. Supp. 3d 1297, 1317 (N.D. Ga. 2015), *vacated on other grounds and remanded*, 825 F.3d 1236 (11th Cir. 2016); Smith, *supra* note 44.

172 *See Freytag*, 501 U.S. at 881–82.

173 *See Hill*, 114 F. Supp. 3d at 1317; *see also* Duka v. SEC, No. 15 Civ. 357, 2015 U.S. Dist. LEXIS 100999, at *5 (S.D.N.Y. Aug. 3, 2015) ("SEC ALJs are 'inferior officers' because they exercise 'significant authority pursuant to the laws of the United States.'" (quoting *Hill*, 114 F. Supp. 3d at 1317)). The SEC is a "Department" for the purposes of the Appointments Clause, and the Commissioners function as the "Head" of that department. *See PCAOB*, 561 U.S. 477, 511–13 (2010). For a look at how the courts have addressed the Appointments Clause issue in other contexts, see *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 684 F.3d 1332, 1334 (D.C. Cir. 2012) (holding that Copyright Royalty Judges are "officers" under the Appointments Clause); *see also* David Oxenford, *Constitutionality of Copyright Royalty Board Argued Before the US Court of Appeals—How Will It Affect Future Music Royalty Rate-Setting?*, BROAD. L. BLOG (Feb. 9, 2012), http://www.broadcastlawblog.com/2012/02/articles/constitutionality-of-copyright-royalty-board-argued-before-the-us-court-of-appeals-how-will-it-affect-future-music-royalty-rate-setting.

174 *See Hill*, 114 F. Supp. 3d at 1317–19; Geoffrey F. Aronow, *Back to the Future: The Use of Administrative Proceedings for Enforcement at the CFTC and SEC*, FUTURES & DERIVATIVES L. REP. (Thomson Reuters), Jan.–Feb. 2015, at 1, 5–6; Hardy, Kendall & Rein, *supra* note 7.

175 *See* 5 U.S.C. § 556 (2012); 15 U.S.C. § 78d-1(a); 17 C.F.R. § 200.14(a) (2016).

176 *See* 5 U.S.C. § 556; 15 U.S.C. § 78d-1(a); 5 U.S.C. § 5372 (salary); *id.* § 3105 (means of

conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders.[177] In many respects, the authority of an ALJ is parallel to the authority of a trial judge presiding over a bench trial.[178] Relying on *Landry*, the SEC emphasized that the ALJs cannot issue final orders and do not have contempt power.[179] However, because the STJ's limited authority to issue final orders was only an additional reason for the *Freytag* court's holding, the court, contrary to the court in *Landry*, concluded that *Freytag* only required a finding that the SEC's ALJs exercised significant authority.[180]

Having found that the SEC's ALJs are inferior officers, the court reasoned that they must be appointed by the President, the Courts of Law, or by the Heads of the Department: namely, the SEC Commissioners.[181] The SEC had conceded that plaintiff's ALJ, James E. Grimes, was not appointed by an SEC Commissioner.[182] Because

appointment); 17 C.F.R. § 200.14(a); *id.* § 200.14 (duties); *id.* § 201.111; 5 C.F.R. § 930.204 (means of appointment). For a table that lists examples of those duties, see Bandimere v. SEC, No. 15-9586, 2016 WL 7439007, *7 (10th Cir. Dec. 27, 2016).

177 *See Freytag*, 501 U.S. at 881; *Hill*, 114 F. Supp. 3d at 1317–18; *see also* 17 C.F.R. § 201.360(a)(1) (power to issue initial decision); *id.* § 201.111(i) (power to issue initial decision); *id.* § 201.111 (power to conduct trials and take testimony); *id.* § 201.111(c) (power to rule on admissibility of evidence); *id.* § 201.32 (power to rule on admissibility of evidence); *id.* § 201.141 (power to issue orders); *id.* § 201.230(a)(2) (power to order the production of evidence); *id.* § 201.250 (power to rule on requests ad motions, including pre-trial motions for summary disposition); *id.* § 201.161 (power to grant extensions of time); *id.* § 201.111(h) (power to reconsider their own or other SEC ALJ decision); *id.* § 201.111(b) (power to issue subpoenas); *id.* §201.232 (power to issue subpoenas); *id.* § 201.180 (power to impose sanctions); *id.* § 201.233 (power to order depositions and act as the deposition officer); *id.* § 201.234 (power to order depositions and act as the deposition officer); *id.* § 201.155 (power to enter orders of default); *id.* § 201.323 (power to take official notice of facts not on the record); *id.* § 201.326 (power to regulate the scope of cross-examination).

178 *See Hill*, 114 F. Supp. 3d at 1317–19; Hardy, Kendall & Rein, *supra* note 7; *see also* Butz v. Economou, 438 U.S. 478, 513 (1978) ("There can be little doubt that the role of the . . . administrative law judge . . . is 'functionally comparable' to that of a judge. His powers are often, if not generally, comparable to those of a trial judge: He may issue subpoenas, rule on proffers of evidence, regulate the course of the hearing, and make or recommend decisions."). Indeed, the Supreme Court has deemed others who have far less or equal authority than the ALJs to be inferior officers. Barnett, *supra* note 33, at 812. "The Court has held that district-court clerks, thousands of clerks within the Treasury and Interior Departments, an assistant surgeon, a cadet-engineer, election monitors, federal marshals, military judges, Article I judges, and the general counsel for the Transportation Department are inferior officers." *Id.* (footnote omitted); *see also PCAOB*, 561 U.S. 477, 540 (Breyer, J., dissenting) (citing cases).

179 *See* 17 C.F.R. § 201.180(a); *Hill*, 114 F. Supp. 3d at 1317 n.9.

180 *See Hill*, 114 F. Supp. 3d at 1318.

181 *See id.* at 1319; *see also* U.S. CONST. art. II, § 2, cl. 2. Of course, as a constitutional matter, the SEC's ALJs could also be appointed by the President with advice and consent of the Senate.

182 *See Hill*, 114 F. Supp. 3d at 1319; Defendant's Answer to Amended Complaint, Duka v. SEC, 124 F. Supp. 3d 287 (S.D.N.Y. 2015), *vacated and remanded*, No. 15-2732 (2d Cir. June 13, 2016). The SEC has also conceded that ALJ Cameron Elliot, who is presiding over the administrative proceeding against Gray Financial Group, Inc., was not appointed by the Commissioners. Mark S. Nelson, *SEC Admits Two ALJs Not Appointed by Commissioners*, JIM

Grimes was not properly appointed pursuant to Article II, the court opined that his appointment was likely unconstitutional.[183] Thus finding that Hill had established a likelihood of success on the merits of her Appointments Clause claim, the court preliminarily enjoined the SEC from continuing with its administrative proceeding.[184] The SEC appealed the district court's determination to the Eleventh Circuit, where it ultimately concluded that the district court did not have jurisdiction to hear this constitutional challenge except through administrative review.[185]

Following *Hill*, the U.S. District Court for the Southern District of New York also issued a preliminary injunction in favor of Duka.[186] Finding that the SEC's ALJs are inferior officers, Judge Berman held that because ALJ Cameron Elliot was not hired through a process involving the approval of the Commissioners, pursuant to Article II, his appointment was likely unconstitutional.[187] However, the Second Circuit joined the Seventh, Eleventh, and District of Columbia Circuits in refusing to address the merits of defendants' claims on the ground that the federal courts lack subject matter jurisdiction to hear these

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HAMILTON'S WORLD SEC. REG. (Oct. 5, 2015), http://jimhamiltonblog.blogspot.com/2015/10/sec-admits-two-aljs-not-appointed-by.html. In addition, the SEC has conceded that ALJ Carol Fox Foelak, who is presiding over the administrative proceeding in *Tilton*, was not appointed by the SEC Commissioners.

183 *Hill*, 114 F. Supp. 3d at 1319

184 *Id.* at 1319–21; Glassman, *supra* note 3.

185 Hill v. SEC, 825 F.3d 1236 (11th Cir. 2016); *see also* Jody Godoy, *11th Circ. Backs SEC in Challenge to In-House Judges*, LAW360 (June 17, 2016, 3:58 PM), http://www.law360.com/securities/articles/808279?nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities. Also before the Eleventh Circuit was the case of *Gray Financial Group, Inc. v. SEC*. *See* Gray Fin. Grp., Inc. v. SEC, No. 15-13738-FF (11th Cir. Oct. 7, 2015). In *Gray*, Judge May issued a preliminary injunction and also refused to stay the injunction pending appeal because the SEC did not make a strong showing that it would win its appeal the merits. *See* Gray Fin. Grp., Inc. v. SEC, 166 F. Supp. 3d 1335 (N.D. Ga. 2015), *vacated and remanded*, *Hill*, 825 F.3d 1236; Stewart Bishop, *SEC Can't Pause Order Blocking In-House Court Proceeding*, LAW360 (Sept. 25, 2015, 6:34 AM), http://www.law360.com/articles/707212/sec-can-t-pause-order-blocking-in-house-court-proceeding; Carmen Germaine, *11th Circ. Won't Lift Order Blocking SEC In-House Suit*, LAW360 (Oct. 7, 2015, 9:02 PM), http://www.law360.com/articles/711691/11th-circ-won-t-lift-order-blocking-sec-in-house-suit; Mark S. Nelson, *Judge Nixes SEC Bid to Hear In-House Case as Eleventh Circuit Mulls ALJ Issue*, JIM HAMILTON'S WORLD OF SEC. REG. (Sept. 28, 2015), http://jimhamiltonblog.blogspot.com/2015/09/judge-nixes-sec-bid-to-hear-in-house.html. However, as with *Hill*, the Eleventh Circuit vacated the district court's ruling for lack of subject matter jurisdiction. *See Hill*, 825 F.3d at 1236.

186 *See* Duka v. SEC, 124 F. Supp. 3d 287 (S.D.N.Y. 2015), *vacated and remanded*, No. 15-2732 (2d Cir. June 13, 2016).

187 *See* Duka v. SEC, No. 15 Civ. 357, 2015 U.S. Dist. LEXIS 100999, at *6–7 (S.D.N.Y. Aug. 3, 2015); Respondents' Notice of Filing Supplemental Authority, Timbervest, L.L.C., Admin Proc. File No. 3-15519 (attached as Ex. 1 to Amended Complaint, dated June 10, 2015).

claims in the first instance.[188] According to these courts of appeal, the administrative law courts have exclusive jurisdiction over the plaintiff's constitutional claims, and judicial review can only come from the courts of appeal following the administrative proceeding and the SEC's issuance of a final order.[189] However, Judge Randa, the District Judge for the U.S. District Court for the Eastern District of Wisconsin, did find Defendant Bebo's claims "compelling and meritorious."[190]

In recent months, the circuit court for the District of Columbia became the first appellate court to address the merits of the Appointments Clause issue following the SEC's issuance of a final order.

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188 *See* cases cited *supra* note 14; *see also* Carmen Germaine, *SEC Beats Tilton's 2nd Circ. Challenge to In-House Court*, LAW360 (June 1, 2016, 10:48 AM), http://www.law360.com/securities/articles/802404?nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities; Kurt Orzeck, *2nd Circ. Lets SEC Proceed with Case Against Ex-S&P Exec*, LAW360 (June 13, 2016, 10:58 PM), http://www.law360.com/securities/articles/806730?nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities. However, the Second Circuit has agreed to keep the stay in effect until the appeals court decides a move for a rehearing. *See* Stewart Bishop, *2nd Circ. Keeps Stay of Duka's SEC In-House Suit, For Now*, LAW360 (July 5, 2016, 7:07 PM), http://www.law360.com/securities/articles/813853?nl_pk=6ddc9a3d-3249-4d38-b1c8-b63f1c981b81&utm_source=newsletter&utm_medium=email&utm_campaign=securities.

189 *See* 15 U.S.C. § 78y (2012); *see, e.g.*, Jarkesy v. SEC, 803 F.3d 9, 15 (D.C. Cir. 2015); Bebo v. SEC, 799 F.3d 765, 767 (7th Cir. 2015). The courts analyzed whether Congress's statutory review scheme "display[ed] a 'fairly discernible' intent to limit jurisdiction," and if the claims at issue were "of the type that Congress intended to be reviewed within th[e] statutory structure." *See* Bebo v. SEC, No. 15-C-3, 2015 U.S. Dist. LEXIS 25660, at *4 (E.D. Wis. Mar. 3, 2015); *Jarkesy*, 803 F.3d 9; *see also PCAOB*, 561 U.S. 477, 489 (2010) (quoting Thunder Basin Coal Co. v. Reich, 510 U.S. 200, 212 (1994)). A court may presume that Congress did not intend to limit jurisdiction if (1) "a finding of preclusion could foreclose all meaningful judicial review"; (2) "the suit is 'wholly collateral to a statute's review provisions'"; and (3) "the claims are 'outside the agency's expertise.'" *Id.* at 489 (quoting *Thunder Basin Coal Co.*, 510 U.S. at 212–13). In *Bebo*, Judge Hamilton considered the first prong to be the most critical. *Bebo*, 799 F.3d at 767 ("Although Bebo's suit can reasonably be characterized as 'wholly collateral' to the statute's review provisions and outside the scope of the agency's expertise, a finding of preclusion does not foreclose all meaningful judicial review."). Judge Hamilton's decision was based primarily upon the fact that since Bebo was already a defendant in a pending administrative proceeding she would not need to "risk incurring a sanction voluntarily just to bring her constitutional challenges before a court of competent jurisdiction. After the pending enforcement action has run its course, she can raise her objections in a circuit court of appeals." *Id.* at 774. In contrast, Judge Srinivasan performed a holistic analysis of all three factors, finding it clear that Congress intended the statutory review scheme to be exclusive because "Congress granted the choice of forum to the Commission, and that authority could be for naught if respondents like Jarkesy could countermand the Commission's choice by filing a court action." *Jarkesy*, 803 F.3d at 15–17. The courts that did address the constitutional claims on the merits found these factors pointed in favor of finding that Congress did not intend to limit jurisdiction. *See Duka*, 2015 U.S. Dist. LEXIS 100999; *Hill*, 114 F. Supp. 3d 1297; *Gray Fin. Grp., Inc.*, 166 F. Supp. 3d 1335; Gupta v. SEC, 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

190 *See Bebo*, 2015 U.S. Dist. LEXIS 25660, at *3 (D. Wisc. Mar. 3, 2015); *see also* Thomas Potter, III, *SEC ALJ Slams Bebo; Summarily Denies ConLaw Challenge*, JD SUPRA (Oct. 12, 2015), http://www.jdsupra.com/legalnews/sec-alj-slams-bebo-summarily-denies-37398.

In *Raymond J. Lucia Companies, Inc. v. SEC*,[191] Judge Rogers held that the ALJs working for the SEC are *not* officers subject to the requirements of the Appointments Clause but merely employees.[192] Explicitly adopting the approach in *Landry* as the "law of the circuit," the court relied on the fact that the initial decision rendered by an ALJ does not become final until the SEC "affirmatively act[s]" by issuing a new decision after *de novo* review, or, by declining to grant review, its acceptance of the ALJ's decision as its own. [193]

Shortly thereafter, the Tenth Circuit created a split in opinion amongst the circuit courts of appeals by holding that the ALJ appointment scheme *is* a violation of the Appointments Clause. In *Bandimere v. SEC*,[194] Judge Matheson held that the SEC's ALJs *are* inferior officers subject to the requirements of the Appointments Clause.[195] Adopting the approach in *Freytag*, the court relied on the fact that (1) "the position of the SEC ALJ was 'established by law,'" (2) "the duties salary, and means of appointment . . . are specified by statute," and (3) "the SEC ALJs 'exercise significant discretion' in 'carrying out . . . important functions."[196] The court also pointed out that the ALJs have the authority to issue initial decisions that "declare respondents liable and impose sanctions," which can be deemed the action of the Commission should the respondent not seek timely review or if the SEC declines to review the initial decision.[197]

III. THE SEC SHOULD CURE ITS ALJ APPOINTMENT SCHEME IN A MANNER THAT INDISPUTABLY COMPLIES WITH THE APPOINTMENTS CLAUSE

With these alleged constitutional infirmities in mind, it may seem impossible for the SEC to continue to use its administrative law courts, at least for the foreseeable future or until the Supreme Court agrees to hear these constitutional challenges. However, this is not necessarily the case. The courts have not seemed to grab hold of the alleged due process and Seventh Amendment violations,[198] and even if the courts begin to

191 Raymond J. Lucia Cos., Inc. v. SEC, 832 F.3d 277 (D.C. Cir. 2016).

192 *Id.* at 286.

193 *Id.* at 285–86.

194 Bandimere v. SEC, No. 15-9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016).

195 *Id.* at *7.

196 *Id.* at *8 (quoting Freytag v. Comm'r, 501 U.S. 868, 881–82 (1991)).

197 *Id.* at *9 (internal citations omitted).

198 *See Hill*, 114 F. Supp. 3d at 1315–16 (rejecting the jury trial argument because Dodd-Frank related to public rights, and Congress has the right to send public rights cases to administrative proceedings); *see also Bebo*, 2015 U.S. Dist. LEXIS 25660 (no jurisdiction over due process, equal protection, Seventh Amendment . . . claims); Chau v. SEC, 72 F. Supp. 3d

do so, the SEC has already approved changes to the SEC's Rules of Practice, which are supposed to give defendants more of the legal protections available in federal court.[199] While this attempt to quash defendant's constitutional claims may not go far enough to protect defendant's constitutional rights,[200] Congress may fix the problem without the SEC having to do anything. Recently, Rep. Scott Garrett (R-NJ), Chairman of the Financial Services Subcommittee on Capital Markets and Government-Sponsored Enterprises, introduced the Due Process Restoration Act.[201] This piece of legislation would, among other things, provide defendants with the option of having their case heard in federal court.[202] If defendants were able to waive their right to a trial by jury, this would itself quash defendants' constitutional claim that the SEC's in-house procedures violate their Seventh Amendment and due process rights. Thus, unless the courts begin to latch on to these due process arguments, these allegations will not hinder the SEC's use of its administrative forum.[203]

Similarly, the contention that the SEC's removal scheme violates Article II of the Constitution because the ALJs enjoy multiple layers of tenure protection also seems unlikely to prevent the SEC from bringing its enforcement actions as administrative proceedings.[204] The critical question seems to turn on whether the multi-layer tenure protections infringe on the President's ability to perform his constitutional responsibilities.[205] In accord with the courts' determination in *Duka*, *Hill*, and *Gray*, because the ALJs do not occupy a purely executive position—they are adjudicators—it is doubtful that their multi-layer tenure protections would interfere with the President's duties.[206]

417, 430, 436 (S.D.N.Y. 2014) (no jurisdiction over due process and equal protection claims); Altman v. SEC, 768 F. Supp. 2d 554, 562 (S.D.N.Y. 2011) (no jurisdiction over due process, equal protection . . . claims). *See generally* Hardy, Kendall & Rein, *supra* note 7.

199 *See* discussion *supra* Section II.A.

200 *See supra* notes 110, 113.

201 H.R. 3798, 114th Cong. (2015); Press Release, U.S. Congressman Scott Garrett, Garrett Introduces Bill to Restore Due Process Rights for All Americans (Oct. 22, 2015), http://garrett.house.gov/media-center/press-releases/garrett-introduces-bill-to-restore-due-process-rights-for-all-americans [http://web.archive.org/web/20161228150532/http://garrett.house.gov/media-center/press-releases/garrett-introduces-bill-to-restore-due-process-rights-for-all-americans].

202 *Id.* Jean Eaglesham, *SEC Faces New Attack on In-House Judges*, WALL STREET J. (Oct. 21, 2015, 3:15 PM), http://blogs.wsj.com/law/2015/10/21/sec-faces-new-attack-on-in-house-judges/?mod=wsj_valettop_email.

203 *See supra* note 198; *see also supra* note 94.

204 *See* discussion *supra* Section II.B.

205 *See* discussion *supra* Section II.B.

206 *See supra* note 145; *see also* Giles D. Beal IV, *Judge, Jury, and Executioner: SEC Administrative Law Judges Post-Dodd Frank*, 20 N.C. BANKING INST. 413 (2016) (holding that the scheme for removal of SEC ALJs is likely constitutional).

However, there is one allegation that may hinder the SEC's use of its administrative law courts: the contention that the SEC's appointment scheme violates the Appointments Clause of the Constitution.[207] Recently, more and more courts have found that the SEC's ALJ's are inferior officers, and, as such, must be appointed in accordance with the procedures set forth in Article II.[208] Even one of the courts that dismissed the case for lack of subject matter jurisdiction found the Appointments Clause argument compelling.[209] Although the SEC recently obtained its first victory in the D.C. Circuit Court of Appeals on the Appointments Clause issue,[210] the Court of Appeals for the Tenth Circuit just created a split in opinion between the circuits by holding that the SEC's appointment scheme for its ALJs is a violation of the Appointments Clause.[211] Given this recent decision,[212] and the other district courts' findings,[213] and the SEC's stated intention to bring a greater percentage of cases as administrative proceedings,[214] the number of challenges will likely only increase.[215] The Appointments Clause issue is far from over and will likely appear before the Supreme Court in the near future. In order to continue using its advantageous forum, the SEC can and should cure its appointment scheme by having the five Commissioners approve ALJ appointments.[216]

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207 *See supra* note 13; discussion *supra* Section II.C.

208 *See* Gray Fin. Grp., Inc. v. SEC, 166 F. Supp. 3d 1335 (N.D. Ga. 2015), *vacated and remanded*, *Hill*, 825 F.3d 1236; Duka v. SEC, No. 15 Civ. 357, 2015 U.S. Dist. LEXIS 100999 (S.D.N.Y. Aug. 3, 2015); Hill v. SEC, 114 F. Supp. 3d 1297 (N.D. Ga. 2015), *vacated on other grounds and remanded*, 825 F.3d 1236 (11th Cir. 2016).

209 *See* discussion *supra* note 190.

210 Raymond J. Lucia Cos., Inc. v. SEC, 832 F.3d 277 (D.C. Cir. 2016).

211 *See* Bandimere v. SEC, No. 15, 9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016).

212 *Id.*

213 *See* discussion *supra* Section II.C.

214 *See supra* note 17.

215 *See* Johnson & Juris, *supra* note 4. Brian Miller, Chair of the Securities Litigation Practice at Akerman L.L.P., said that there is a potential for the Eleventh Circuit to create a circuit split and he "would not be surprised to see the Supreme Court take up the case." Ed Beeson, *Securities Cases to Watch in 2016*, LAW360 (Dec. 24, 2015, 8:38 PM), https://www.law360.com/articles/739582/securities-cases-to-watch-in-2016. In recent months, a number of defendants have brought suit in federal district court to enjoin the SEC from using its administrative forum. *See* Ironridge Global IV, Ltd. v. SEC, 146 F. Supp. 3d 1294 (N.D. Ga. 2015) (Judge May granted injunction); Bennett v. SEC, 151 F. Supp. 3d 632 (D. Md. 2015) (injunction denied by Judge Grimm); Memorandum of Law in Support of Plaintiffs' Motion for a Preliminary Injunction, *Bennet*, 151 F. Supp. 3d 632 (No. 15-cv-03325); Verified Complaint for Declaratory and Injunctive Relief, Daspin v. SEC, No. 2:15-cv-08299 (D.N.J. Nov. 25, 2015) (dismissed for lack of subject matter jurisdiction). The defendant in *Bennett* has appealed Judge Grimm's decision to the Fourth Circuit. *See* Ed Beeson, *Adviser's Spat over SEC In-House Court Heads to 4th Circ.*, LAW360 (Dec. 22, 2015, 9:54 PM), https://www.law360.com/articles/740973/adviser-s-spat-over-sec-in-house-court-heads-to-4th-circ.

216 *See* Jones, *supra* note 22, at 510 ("[G]iven the amount of respondents persistently filing such challenges . . . the circuit courts–and perhaps, eventually, the Supreme Court–will

While this may seem like a relatively easy constitutional fix,[217] there are at least three reasons the SEC may be disinclined to implement it. First, the SEC may be hesitant to concede the merits of a legal issue it is currently litigating.[218] However, just because the SEC amends its method of appointment does not mean that it admits that the way in which its ALJs have been appointed is unconstitutional. The SEC can announce this change as a mere desire to prevent further disruption of its ability to police violations of securities laws.[219]

Second, the SEC may hesitate to amend its current procedures given the potential retroactive effect such action may produce.[220] While it is reasonable for the SEC to be concerned about the res judicata effect of prior ALJ determinations, even if this amendment is deemed a concession, it will not have the retroactive ramifications which the SEC fears.[221] Not every party who has been subject to an administrative proceeding before an unconstitutionally appointed ALJ would be able to successfully attack the validity of the ALJ's rulings.[222] Once a judgment has become final, meaning the time to appeal has expired or a petition for certiorari has been denied, the court's ability to correct errors is typically restrained by the principle of finality.[223] Even a showing that the adjudicator lacked subject matter jurisdiction will not outweigh the

probably review these cases in the near future."); Hardy, Kendall & Rein, *supra* note 7; discussion *supra* Section II.C; *see also* discussion *infra* Part IV.

217 Judge May said the constitutional defect "could easily be cured by having the SEC Commissioners issue an appointment or preside over the matter themselves," and thus first give the SEC an opportunity to cure the appointments clause violation before finalizing her order. *See* Hill v. SEC, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015), *vacated on other grounds and remanded*, 825 F.3d 1236 (11th Cir. 2016); Alison Frankel, *Why the SEC Can't Easily Solve Appointments Clause Problem with ALJs*, REUTERS (June 17, 2015), http://blogs.reuters.com/alison-frankel/2015/06/17/why-the-sec-cant-easily-solve-appointments-clause-problem-with-aljs. Judge Berman also gave the SEC an opportunity to cure the alleged violation, but the SEC, again, refused to take such action. *See* Duka v. SEC, No. 15 Civ. 357, 2015 U.S. Dist. LEXIS 100999, at *7–8 (S.D.N.Y. Aug. 3, 2015).

218 *See* Frankel, *supra* note 217.

219 *See, e.g.*, J. Robert Brown Jr., Duka v. SEC *and the Constitutionality of Administrative Law Judges (Part 7)*, RACE TO THE BOTTOM (Aug. 27, 2015, 6:00 AM), http://www.theracetothebottom.org/home/duka-v-sec-and-the-constitutionality-of-administrative-law-j-5.html (stating that the Commission could characterize this change as an action taken out of "abundance of caution").

220 *See generally* Hardy, Kendall & Rein, *supra* note 7. "[S]ome parties likely will be able to challenge the judgments already issued against them by ALJs in administrative proceedings." *Id.* at 4.

221 *Id.*

222 *Id.*

223 *See* Travelers Indem. Co. v. Bailey, 557 U.S. 137, 154 (2009); James B. Beam Distilling Co. v. Georgia, 501 U.S. 529, 540 (1991) ("[I]n the civil arena . . . there is little opportunity for collateral attack of final judgments"); Durfee v. Duke, 375 U.S. 106, 114–15 (1963); *see also* Hardy, Kendall & Rein, *supra* note 7, at 4.

presumption in favor of finality.[224] Indeed, a court without subject matter jurisdiction is akin to an adjudicator, like an SEC ALJ who was appointed improperly, and therefore lacked the authority to exercise jurisdiction over the case before him.[225] The Supreme Court has made clear that even when a judge lacked the power to preside over a case, once a judgment has become final, the defect cannot be attacked collaterally.[226] Thus, in accord with the principle of finality, it is unlikely that the parties whose ALJ-issued judgments are final will be able to wage a successful collateral attack on the grounds that the ALJ's appointments were unconstitutional.[227]

The de facto officer doctrine,[228] which limits one's ability to challenge governmental action on the ground that the officers taking such action are improperly in office, provides another safeguard against a collateral attack.[229] The de facto officer doctrine presumes that a party suffers no judicially cognizable injury when he is the victim of adverse governmental action that is valid in all respects aside from the fact that the official taking the action lacks lawful title to office.[230] To trigger application of the doctrine, there must be (1) a lawful office, (2) the powers of which the officer exercised under "color of authority," and (3) the action must be within the power of that office.[231] This doctrine seems to be a perfect fit for the SEC's ALJs whose appointments are

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224 *See Bailey*, 557 U.S. at 154 ("[I]f 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'" (quoting *In re* Optical Techs., Inc., 425 F.3d 1294, 1307 (11th Cir. 2005))); *see also Duke*, 375 U.S. at 114–15.

225 See Hardy, Kendall & Rein, *supra* note 7, at 4 for a comparison between a court lacking subject matter jurisdiction and an adjudicator who was appointed improperly and therefore lacked authority to exercise jurisdiction over the case before him.

226 *See* Ryder v. United States, 515 U.S. 177, 182 (1995) ("The title of a person acting with color of authority, even if he be not a good officer in point of law, cannot be collaterally attacked." (quoting *Ex parte* Ward, 173 U.S. 452, 456 (1899))). In *Ryder*, the Supreme Court alluded to the fact that had the defendant in *Ward* attacked the validity of the officer's appointment before the judgment had become final, he would have been entitled to a decision on the merits of the question. *Id.* at 182–83.

227 *See* Hardy, Kendall & Rein, *supra* note 7, at 4.

228 For details regarding the origin of the de facto officer doctrine see ALBERT CONSTANTINEAU, A TREATISE ON THE DE FACTO DOCTRINE 409–28 (1910); Kathryn A. Clokey, Note, *The De Facto Officer Doctrine: The Case for Continued Application*, 85 COLUM. L. REV. 1121, 1125–26 (1985).

229 *See* Andrade v. Lauer, 729 F.2d 1475, 1494, 1496 (D.C. Cir. 1984); *see, e.g.*, Buckley v. Valeo, 424 U.S. 1 (1976); Connor v. Williams, 404 U.S. 549, 550–51 (1972); Harrison v. Schaefer, 383 U.S. 269 (1966); Ball v. United States, 140 U.S. 118 (1891); Equal Emp't Opportunity Comm'n v. Sears, Roebuck & Co., 650 F.2d 14, 18 (2d Cir. 1981); Schaefer v. Thomson, 251 F. Supp. 450, 453 (D. Wyo. 1965), *aff'd sub nom. Harrison*, 383 U.S. 269; Leary v. United States, 268 F.2d 623, 627 (9th Cir. 1959); Clokey, *supra* note 228, at 1122.

230 *See* Clokey, *supra* note 228, at 1122.

231 *See id.* at 1122–23.

deficient.[232] (1) The Office of ALJs is established by law; (2) by presiding over the in-house proceedings the ALJs were acting as if they had the constitutional authority to do so; and (3) the ALJ's adjudicatory functions were within the power of that office.[233] Thus, under the de facto officer doctrine, the allegedly wrongful appointment scheme would seem not to affect the validity of the Commission's administrative functions and determinations because the ALJs were acting, in all respects, the way in which properly appointed ALJs would act under ordinary circumstances.[234] Indeed, from this perspective, the improper appointment was nothing more than a technical defect.[235]

However, for defendants whose administrative determinations are not yet final—namely those that are in the midst of seeking appellate review or for which the period for seeking review has not yet expired—the de facto officer doctrine may not apply. Such defendants will likely be able to use a determination that the SEC's appointment scheme is unconstitutional to void their administrative judgments.[236] First, the Supreme Court has held that a constitutional defect in the manner in which an officer is appointed could invalidate a resulting order.[237] Thus, if the Appointments Clause challenge is timely raised, then, under existing Supreme Court precedent, the defendant should be entitled to relief if the violation indeed occurred.[238] Second, the Supreme Court has in the past rejected the doctrine's application to Appointments Clause challenges in cases where the time to appeal has not expired. For example, in *United States v. American-Foreign S.S. Corp*, the Supreme Court vacated a decision of the Second Circuit *en banc* in which a

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232 *See* Hardy, Kendall & Rein, *supra* note 7, at 5.

233 *See* 17 C.F.R. § 200.14 (2016) (laying out responsibilities of the Office of Administrative Law Judges); *supra* note 176; *see also* Hill v. SEC, 114 F. Supp. 3d 1297, 1317 (N.D. Ga. 2015), *vacated on other grounds and remanded*, 825 F.3d 1236 (11th Cir. 2016).

234 *See, e.g.*, Buckley v. Valeo, 424 U.S. 1 (1975) (upholding all pre-1975 actions of the Federal Election Commission even though the Commission members were appointed in a manner inconsistent with the Constitution).

235 *See, e.g.*, *Sears*, 650 F.2d at 18.

236 *See* Barnett, *supra* note 33, at 810; Hardy, Kendall & Rein, *supra* note 7, at 4–6; *see also* San Remo Hotel, L.P. v. City & Cty. of San Francisco, 545 U.S. 323, 336 n.16 (2005) (noting that res judicata requires a "final judgment on the merits"). In fact, the Court of Appeals for the Tenth Circuit has recently set aside an order of the SEC against a Colorado businessman, which, among other things, held him liable for violations of the securities laws and barred him from the securities industry, all because the ALJ who presided over the case was not appointed according to the requirements of the Appointments Clause. *See* Bandimere v. SEC, No. 15-9586, 2016 WL 7439007 (10th Cir. Dec. 27, 2016).

237 *See* Ryder v. United States, 515 U.S. 177 (1995) (vacating several decisions made by the Coast Guard of Military Review because the appointments of two of the court's officers violated the Appointments Clause); *see also* Nguyen v. United States, 539 U.S. 69, 73–74 (2003); United States v. L.A. Tucker Truck Lines, Inc., 344 U.S. 33, 38 (1952); Am. Constr. Co. v. Jacksonville, T. & K.W. Ry. Co., 148 U.S. 372, 387 (1893).

238 *See Ryder*, 515 U.S. at 182–83.

retired judge participated.[239] The Court held that because a retired circuit judge lacks the power to participate in an en banc court of appeals determination, the judgment must be set aside.[240] However, the Supreme Court has also applied the de facto officer doctrine to cases where the decision is not yet final when there has been a "merely technical"[241] defect of statutory authority,[242] and whether the ALJ's appointment scheme would fall into this scenario is one the courts have yet to decide. Thus, for now, it seems that parties whose administrative decisions are not yet final may be able to capitalize on a court determination that the ALJ's appointment scheme is unconstitutional.[243] Nonetheless, this Note argues that the SEC should still amend its current procedures for appointing ALJs because the number of cases that are not yet final pales in comparison to the myriad of cases that the ALJs have adjudicated to completion, and waiting to cure the appointment scheme will only hinder the SEC from continuing to use its administrative forum without having to address these constitutional attacks.

Notwithstanding the foregoing, there is one lingering thread of hope for the SEC to latch on to. In most of the cases in which the Supreme Court has vacated the decisions on the ground that the adjudicators were improperly appointed, the Court remanded the cases back to the adjudicating body for a new determination made by constitutionally-valid adjudicators.[244] Importantly, remand was only possible in those cases because the constitutional violation would not be repeated because the case would be decided by other, constitutionally-appointed judges.[245] If the SEC can cure the appointment scheme before remand, then the SEC can save those cases from being void.[246] Moreover, even if these cases are dismissed, they would likely be

239 United States v. Am.-Foreign S.S. Corp., 363 U.S. 685 (1960).

240 *Id.*; *see also Nguyen*, 539 U.S. at 74–75, 83 (vacating a decision of the Ninth Circuit Court of Appeals made by a three-judge panel that included an Article IV territorial judge who was ineligible to sit by designation on an Article III court).

241 *Nguyen*, 539 U.S. at 77.

242 *See, e.g.*, McDowell v. United States, 159 U.S. 596, 601–02 (1895).

243 One legal scholar even argues that it is unlikely that courts would apply such a determination retroactively given the impracticalities of vacating past administrative proceedings. David Markewitz, *The SEC's Appointment Problem and Its Likely Solution*, CLS BLUE SKY BLOG (Mar. 18, 2016), http://clsbluesky.law.columbia.edu/2016/03/18/the-secs-appointment-problem-and-its-likely-solution. Rather, he contends, "the ruling is likely to be applied prospectively—according past proceedings *de facto* validity—and stayed to allow the SEC to implement remedial measures." *Id.*

244 *See, e.g.*, *Nguyen*, 539 U.S. at 83; Ryder v. United States, 515 U.S. 177, 188 (1995); *Am.-Foreign S.S. Corp.*, 363 U.S. at 691.

245 *See* Hardy, Kendall & Rein, *supra* note 7, at 5.

246 *Id.* "Absent properly-appointed SEC ALJs to whom vacated decisions can be remanded, prior decisions by improperly-appointed ALJs likely will be voided and dismissed." *Id.*

dismissed without prejudice, and the SEC would, subject to the applicable statute of limitations, be able to bring the same charges in federal court or in a later administrative proceeding before a constitutionally-appointed ALJ.[247] This alternative may actually disincentivize a defendant from seeking to void his administrative adjudication. Aside from the risk that the SEC will go ahead and just bring suit against him in another forum, he faces the possibility of obtaining a "different (and potentially less desirable) outcome."[248]

As the foregoing demonstrates, curing the ALJ appointment scheme will not have the disastrous ramifications that the SEC may fear. To the contrary, altering the appointment scheme by having the five SEC Commissioners sign off on each appointment will ensure that the SEC can bring future administrative proceedings against violators of securities laws, at least for the foreseeable future, without any stumbling blocks or hindrances.

IV. PROPOSED ALJ APPOINTMENT PROCEDURES

The SEC's appointment scheme likely violates the Appointments Clause of the Constitution because the five SEC Commissioners are not involved with the appointments process.[249] While the Securities Exchange Act of 1934 gives the SEC extensive discretion as to its internal hiring processes,[250] the Commission, of course, is still bound by the Appointments Clause.[251] Thus, the SEC must adopt a scheme in which the Commissioners, going forward, put their final stamp of approval on the appointment of each ALJ. To cure the violation, the SEC has three alternatives. First, the SEC can ratify the appointment of the current ALJs by circulating a motion for ratification amongst the five Commissioners and bringing it to a vote. This solution is likely to be the most efficient because it will enable the administrative proceedings to continue unimpeded. Second, the SEC can temporarily remove the current ALJs for "good cause," and then "reinstate" the ALJs in accordance with 5 C.F.R. 930.204, OPM's regulations regarding the

247 *Id.*

248 *Id.*

249 *See* discussion *supra* Section II.C.

250 15 U.S.C. § 78d(b)(1) (2012) provides that "[t]he Commission shall appoint and compensate officers . . . examiners, and other employees in accordance with section 4802 of Title 5." 5 U.S.C. § 4802(b), in turn, provides that "[t]he Commission may appoint and fix the compensation of such . . . examiners . . . *as may be necessary for carrying out its functions under the securities laws* . . . ." (emphasis added).

251 The Commission is also bound by OPM's regulations. *See* 5 U.S.C. §§ 4802(e)–(f) ("The Commission shall consult with the Office of Personnel Management in the implementation of this section [and] [t]his section shall be administered consistent with merit system principles.").

appointment of ALJs. The SEC can also begin the hiring process anew and appoint a new set of ALJs, but this alternative should only be considered as a last resort because having to reappoint new ALJs would disrupt the current flow of administrative proceedings and would be extremely time consuming.

A. *The SEC Should Ratify the Appointment of Current ALJs*

To cure its appointment scheme, the SEC has a relatively easy fix—the five Commissioners can ratify the appointment of the current ALJs. This solution can be accomplished by following a simple, two-step process. First, Chairwoman Mary Jo White shall circulate amongst her fellow Commissioners a motion for ratification of appointment, which shall include the names of each ALJ whose appointment is being challenged and the year in which that ALJ was previously appointed. Then, Chairwoman White shall call a vote on the motion to ratify, which shall be accepted upon the affirmative vote of a majority of the Commissioners.

This two-step process is not new to administrative agencies. In fact, the FTC, facing a similar challenge to an administrative proceeding, recently voted to ratify the appointment of D. Michael Chappell as an FTC ALJ and as the Commission's Chief ALJ.[252] On a Motion by Chairwoman Ramirez, the FTC ratified Judge Chappell's appointment to quash any possible claim that its administrative proceeding violated the Appointments Clause.[253] This decision was made "purely as a matter of discretion," as the Commission rejected the contention that the ALJs it employs are "inferior officers" for purposes of the Appointments Clause.[254]

Adopting this "prophylactic measure"[255] is in the SEC's best interest because it will allow the administrative proceedings to continue unhindered. Clearly, if the Commissioners ratify the appointment of the

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252 *In re* LabMD, Inc., No. 9357, 2014 WL 7495797, at *1–2 (F.T.C. Dec. 29, 2014); *see also* Jody Godoy, *FTC Affirms ALJ's Authority In re* LabMD *Data Privacy Dispute*, LAW360 (Sept. 15, 2015, 8:31 PM), http://www.law360.com/articles/703100/ftc-affirms-alj-s-authority-in-labmd-data-privacy-dispute.

253 Order Denying Respondent LabMD, Inc.'s Motion to Dismiss, *In re* LabMD, Inc., No. 9357 (F.T.C. Sept. 14, 2015).

254 *Id.* at 2. In *In re Lucia*, the Commission also found that its ALJs were not "inferior officers" for purposes of the appointments clause. *See In re* Raymond J. Lucia Cos., Inc., Exchange Act Release No. 75837, Investment Advisers Act Release No. 4190, Investment Company Act Release No. 31806, 2015 WL 5172953 (Sept. 3, 2015), at *23. However, unlike the FTC, many district courts have ruled otherwise. *See* discussion *supra* Section II.C. Thus, the SEC has an even greater incentive to cure its appointment scheme.

255 Markewitz, *supra* note 243.

current ALJs, defendants will no longer be able to allege that the ALJs were appointed in violation of the Appointments Clause. However, there is another, more indirect benefit caused by adopting this proposal, this time for the defendants. Defendants will not have to face a new ALJ who is unfamiliar with the facts of the case, allowing for a smooth transition to constitutionally-appointed ALJs.

B. *The SEC Should "Reinstate" the Current ALJs*

Another practical solution would be for the SEC to temporarily remove the ALJs, and then "reinstate" the ALJs to their previous positions by having the Commissioners sign a formal document approving their reinstatement. Pursuant to 5 C.F.R. § 930.204(g),[256] an agency may "reinstate" a former ALJ who served under 5 U.S.C. § 3105,[257] passed an ALJ examination administered by OPM, and possesses a professional license, and is authorized, to practice law in the United States.[258] The advantage of using subsection (g) of OPM's regulations to cure the ALJ appointment scheme is that, unlike with the general provision for appointment—subsection (a)[259]—the SEC would not need to obtain OPM's approval or make a selection from the list of eligibles provided by OPM.[260] This result can logically be inferred from OPM's specific use of the phrase "[an ALJ] who served under 5 U.S.C. § 3105" in subsection (g) of the regulation,[261] and its non-coincidental omission of the phrase in its remaining sections.

To read subsection (g) any other way would be inconsistent with the remaining provisions of the statute. To illustrate, section 930.204(a) provides that "[a]n agency may appoint an individual to an

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256 5 C.F.R. § 930.204(g) (2016). "An agency may reinstate a former administrative law judge who served under 5 U.S.C. § 3105, passed an OPM administrative law judge competitive examination, and meets the professional license requirement in paragraph (b) of this section." *Id.*

257 5 U.S.C. § 3105 (2012) ("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 this title.").

258 *See* 5 C.F.R. §§ 930.204(b), (g).

> Judicial status is acceptable in lieu of "active" status in States that prohibit sitting judges from maintaining "active" status to practice law. Being in "good standing" is also acceptable in lieu of "active" status in States where the licensing authority considers "good standing" as having a current license to practice law.

Id. § 930.204(b).

259 *Id.* § 930.204(a) ("An agency may appoint an individual to an administrative law judge position only with prior approval of OPM, except when it makes its selection from the list of eligibles provided by OPM.").

260 *Id.*

261 *Id.* § 930.204(g).

administrative law judge position only with prior approval of OPM, except when it makes its selection from the list of eligibles provided by OPM."[262] Similarly, section 930.204(c) provides that "[a]n agency may give an incumbent employee [of newly classified administrative law judge positions] an administrative law judge career appointment if . . . OPM determines the employee meets the qualification requirements . . . ."[263] And again, in section 930.204(d), the regulations specifically state that "[e]xcept as provided in paragraphs (a) and (c) of this section, an agency may not appoint an employee who is serving in a position other than an administrative law judge position to an administrative law judge position."[264] Thus, had OPM intended for former ALJs to be reinstated only upon its approval, it would have stated so explicitly in subsection (g) of the regulation.

Of course, to be eligible for reinstatement, the current ALJs would first have to either resign or be temporarily removed from office. Presumably, the ALJs would be compliant and not object to their resignation because they too desire to continue doing their jobs without having to address these constitutional challenges. Moreover, temporary removal under these circumstances would likely satisfy the "good cause" standard for removal because the Commissioners would only be doing so to ensure the continued use of administrative proceedings in the SEC's administrative law courts. For example, in *Berlin v. Department of Labor*,[265] the U.S. Court of Appeals for the Federal Circuit held that the Department of Labor had "good cause" to remove ALJs as a result of a statute-based determination about how to implement a government-wide budget sequester.[266] The court's reasoning for establishing "good cause" is analogous to the predicament the SEC is currently facing—its ALJs are unable to properly perform their duties because their appointment is constitutionally suspect—and thus there doesn't seem to be any logical reason to find that the SEC cannot establish "good cause" for the removal of its ALJs.[267]

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262 *Id.* § 930.204(a).

263 *Id.* § 930.204(c).

264 *Id.* § 930.204(d).

265 772 F.3d 890 (Fed. Cir. 2014).

266 *Id.*; *see also* Dep't of Labor v. Avery, 120 M.S.P.R. 150 (M.S.P.B. 2013), *aff'd*, 772 F.3d 890 (Fed. Cir. 2014) (holding that the DOL had "good cause" to furlough ALJs for 5.5 days because of funding shortfall).

267 However, this procedure may be a problem for Chief Administrative Law Judge Brenda P. Murray, who was appointed in 1994, long before OPM's current ALJ exam was crafted. *See* Hardy, Kendall & Rein, *supra* note 7.

C. *Appointment of New Administrative Law Judges*

As a last resort, the SEC can also remove the current ALJs for "good cause"—as described above—and then have the Commissioners sign a formal document approving the appointment of new ALJs. However, the process for appointing new ALJs would be extremely burdensome and inefficient. First, to select the best candidates, the SEC will likely want to engage in thorough investigations and interviews. Additionally, potential candidates will either be limited by the list of eligibles provided by OPM, or would require approval from OPM section 930.204(a) of OPM's regulations providing that an agency may appoint an individual to an administrative law judge position only with prior approval of OPM, which could also lengthen the appointment process, given that the SEC would then be dependent on OPM.[268]

While this alternative may be inefficient, it could be the SEC's only hope at curing its appointment scheme if none of the aforementioned alternatives succeed. However, the benefits of curing the appointment scheme surely outweigh any inefficiency that this option may cause.[269] It will enable the SEC to continue to use its desired administrative forum, at least for the foreseeable future.

CONCLUSION

Since the passage of Dodd-Frank, the SEC has increasingly favored its administrative forum rather than pursuing claims against any person for violations of securities laws in federal court. As a result, the SEC has seen an increasing number of defendants seeking to enjoin the SEC from bringing its cases in its administrative law courts, alleging various constitutional deficiencies with the SEC's administrative proceedings and the ALJs who adjudicate them. Unlike the other alleged constitutional infirmities, the Appointments Clause issue is the one gaining traction in the courts. Rather than risk not being able to continue using its preferred forum, the SEC should cure its ALJ appointment scheme. To that end, the SEC should adopt at least one of the three proposed alternatives, each involving the five SEC Commissioners formally approving the appointment of the ALJ.

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268 5 C.F.R. § 930.204.

269 *See supra* Section I.D, Part III.