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# Judge, Jury, and Executioner: SEC Administrative Law Judges Post-Dodd Frank

Giles D. Beal IV

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# Judge, Jury, and Executioner: SEC Administrative Law Judges Post-Dodd Frank

## I. INTRODUCTION

Representative Scott Garrett, Chairman of the Financial Subcommittee on Capital Markets and Government-Sponsored Entities, recently stated, “[s]trong enforcement of the securities laws is an essential part of the SEC’s mission to protect investors and maintain a fair and efficient marketplace, but in recent years the agency has transformed into a veritable judge, jury, and executioner with its blatant overuse of their in-house courts.”<sup>1</sup> Representative Garrett’s comments stem from the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”), which significantly expanded the powers of the Securities and Exchange Commission’s (the “SEC”) administrative law judges (“ALJs”).<sup>2</sup> Specifically, Dodd-Frank extended SEC ALJs’ ability to levy civil penalties on non-registered individuals and entities, while simultaneously expanding the range of penalties available to ALJs in administrative hearings.<sup>3</sup>

With this expansion of power, a variety of constitutional challenges over the role of SEC ALJs have arisen in federal courts.<sup>4</sup>

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1. Press Release, Representative Scott Garrett, House of Representatives, 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>.

2. See Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 929P, 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012) (expanding the penalties available to SEC ALJs in administrative hearings); Dodd-Frank § 925, 15 U.S.C. §§ 78o, 78o-4, 78q-1, 78u-3, 80b-3 (2012) (extending SEC ALJ jurisdiction to unregistered entities and persons).

3. See Dodd-Frank § 929P, 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012) (expanding the penalties available to SEC ALJs in administrative hearings); Dodd-Frank § 925, 15 U.S.C. §§ 78o, 78o-4, 78q-1, 78u-3, 80b-3 (2012) (extending SEC ALJ jurisdiction to unregistered entities and persons).

4. See *e.g.*, *Duka v. U.S. SEC*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605 (S.D.N.Y. Aug. 12, 2015) (order granting preliminary injunction); *Hill v. SEC*, 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822 (N.D. Ga. June 8, 2015) (order granting preliminary injunction); *Gray Fin. Grp., Inc. v. SEC*, 1:15-CV-0492-LMM, 2015 U.S. Dist. LEXIS 131792 (N.D. Ga. Aug. 4, 2015) (order granting preliminary injunction).

While most industry interest has focused on violations of due process and equal protection,<sup>5</sup> constitutional challenges to the appointment and removal process of SEC ALJs have recently gained more traction among federal judges.<sup>6</sup> These challenges primarily focus on the disputed classification of SEC ALJs as “inferior officers” as opposed to mere employees under the Constitution.<sup>7</sup> Currently, SEC ALJs are considered mere employees and are hired by the chief SEC ALJ.<sup>8</sup> However, under the Appointments Clause of the Constitution, if SEC ALJs are held to be “inferior officers,” then they would require appointment by the President, courts of law, or an SEC commissioner.<sup>9</sup>

Likewise, the removal process for SEC ALJs would be constitutionally suspect if they are deemed to be “inferior officers.”<sup>10</sup> The Supreme Court’s 1989 decision in *Morrison v. Olson* and its 2010 decision in *Free Enterprise Fund v. Public Co. Accounting Oversight Board* revealed that extensive insulation from presidential removal may be unconstitutional if the President has insufficient control over executive branch policy-making and decisions.<sup>11</sup> As the removal process of SEC ALJs is currently structured, three layers of insulation protect these ALJs

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5. See David Zaring, *Enforcement Discretion at the SEC*, 95 TEX. L. REV., 35–49, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2651671##](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2651671##) (forthcoming 2016) (arguing for the constitutionality of both SEC ALJs and the structure of administrative hearings).

6. See e.g., *Duka*, 2015 U.S. Dist. LEXIS 106605; *Hill*, 2015 U.S. Dist. LEXIS 74822; *Gray Fin. Grp., Inc.*, 2015 U.S. Dist. LEXIS 131792.

7. See *Duka*, 2015 U.S. Dist. LEXIS 106605, at \*3–4; *Hill*, 2015 U.S. Dist. LEXIS 74822, at \*43; *Gray Fin. Grp., Inc.*, 2015 U.S. Dist. LEXIS 131792, at \*34–35.

8. See SEC’s Resp. to Order, *Timbervest v. Securities and Exchange Commission*, No. 3-15519, 2 (June 4, 2015) <https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf> (responding to SEC Commission’s order for an affidavit and any supporting materials “setting forth the manner in which administrative law judge (ALJ) Cameron Elliot and Chief ALJ Brenda Murray were hired, including the method of selection and appointment”).

9. See U.S. Const. art. II, § 2, cl. 2. (vesting power of appointment of inferior officers exclusively in the President, Courts of Law, or the Heads of Departments).

10. See *id.* (vesting power of appointment of inferior officers in the President, Courts of Law, or the Heads of Departments); see also *Morrison v. Olson*, 487 U.S. 654, 691–92 (1988) (stating that congressional limits on the removal power will be upheld as long as they do not “unduly trammel[] on executive authority” or “impermissibly burden[] the President’s power to control or supervise” independent officers.); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 492 (2010) (finding the “dual for-cause limitations on removal of Board members” unconstitutional under Article II).

11. See *Morrison*, 487 U.S. at 691–92 (stating that congressional limits on the removal power will be upheld as long as they do not “unduly trammel[] on executive authority” or “impermissibly burden[] the President’s power to control or supervise” independent officers); see also *Free Enter. Fund*, 561 U.S. at 492 (finding the “dual for-cause limitations on removal of Board members” unconstitutional under Article II).

from presidential removal.<sup>12</sup> As a result, the removal process may be unconstitutional due to insufficient presidential control over executive policy.<sup>13</sup>

This Note examines the constitutional debate surrounding the appointment and removal of SEC ALJs in five parts. Part II explores the possible avenues the SEC's Division of Enforcement has in bringing an enforcement action and the SEC's increasing trend toward bringing enforcement actions in front of ALJs post-Dodd Frank.<sup>14</sup> Part III then argues that the appointment of SEC ALJs has been unconstitutional since the passage of Dodd-Frank in 2010 and addresses the SEC's response to recent constitutional challenges.<sup>15</sup> More specifically, Part III argues that the expanded role and powers of SEC ALJs post-Dodd-Frank have transformed these officials into inferior officers more similar to the Special Trial Judges ("STJs") in federal tax court than their ALJ counterparts in other executive agencies.<sup>16</sup> Therefore, it is argued that the current appointment of these inferior officers is unconstitutional and should instead be handled by constitutionally appropriate officials, not by the Chief ALJ.<sup>17</sup> Part IV examines the constitutionality of the removal process for ALJs currently followed by the SEC.<sup>18</sup> This Part reaches the conclusion that although SEC ALJs are insulated from removal by essentially three levels of protection, this process is most likely constitutional, as the President's control over executive branch policy and function is not seriously threatened.<sup>19</sup> Part V concludes by discussing the potential consequences of the SEC's appointment process being held unconstitutional.<sup>20</sup> If the process were held to be unconstitutional, it could potentially call into question hundreds of rulings and billions of dollars in penalties levied since 2010.<sup>21</sup>

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12. See Zaring, *supra* note 5, at 32.

13. See *id.*

14. See *infra* Part II.

15. See *infra* Part III.

16. See *id.*

17. See *id.*

18. See *infra* Part IV.

19. See *id.*

20. See *infra* Part V.

21. See 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/> (discussing the SEC's difficulty in resolving the constitutional disputes over the appointment

II. THE PROCESS OF INITIATING AN SEC ENFORCEMENT PROCEEDING,  
THE RECENT TREND TOWARD ADMINISTRATIVE LAW HEARINGS, AND  
RECENT CHALLENGES TO THIS TREND

Before addressing the constitutional issues surrounding the appointment and removal of SEC ALJs, it is important to note the various options the SEC has in bringing an enforcement action and the increasing frequency with which it brings these enforcement actions before its ALJs.<sup>22</sup> In determining the manner in which to bring an enforcement action, the SEC's Division of Enforcement has two primary avenues: a federal district court proceeding or an administrative law hearing.<sup>23</sup> If an action is brought as an administrative law hearing, the Division of Enforcement participates as a party and must prove the SEC's case.<sup>24</sup> After a decision is rendered, either the defendant or the Division of Enforcement can appeal the decision to the five-person SEC Commission.<sup>25</sup> Following the Commission's decision, the defendant or the Division of Enforcement can appeal to the appropriate federal district court.<sup>26</sup> Historically, congressional limitations on which proceedings could be brought in front of ALJs along with the SEC's infrequent use of ALJs resulted in little discontent among defendants participating in administrative law proceedings.<sup>27</sup> Yet, recent changes to legislation and SEC policy have significantly increased the use of ALJs and concomitantly magnified defendants' discontent over their extensive

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of ALJs).

22. See Peter D. Hardy et al., *The Appointment of SEC Administrative Law Judges: Constitutional Questions and Consequences for Enforcement Actions*, BLOOMBERG BNA, SEC. & REG. L. REP., 47 SRLR 1238 (June 22, 2015), [http://www.postschell.com/site/files/post\\_schell\\_bloomberg\\_bna\\_sec\\_alj\\_constitutional\\_questions\\_6\\_19\\_15.pdf](http://www.postschell.com/site/files/post_schell_bloomberg_bna_sec_alj_constitutional_questions_6_19_15.pdf) (discussing the current constitutional challenges to SEC ALJs and the future of administrative proceedings).

23. See 17 C.F.R. §202.5(b) (2015) (detailing the options the SEC has in instituting enforcement proceedings).

24. See Ryan Jones, *The Fight Over Home Court: An Analysis of the SEC's Increased Use of Administrative Proceedings*, 68 SMU L. REV. 508, 511 (Spring 2015) (arguing that recent challenges to the constitutionality of SEC administrative law proceedings are most likely valid and the SEC should revert to bringing enforcement actions in federal court).

25. See generally Securities Act § 9(a), 15 U.S.C. § 77i (2012); Exchange Act § 25(a)(1), 15 U.S.C. § 78(y) (2012); Investment Advisers Act § 213(a), 15 U.S.C. § 80b-13(a) (2012); Investment Company Act § 43(a), 15 U.S.C. § 80a-42 (2012); Jones, *supra* note 24, at 511.

26. Jones, *supra* note 24, at 511.

27. See *id.* at 520–21 (discussing how recent legislative enactments have led to increased use of SEC ALJs and correspondingly increased discontent).

use.<sup>28</sup>

Prior to the passage of Dodd-Frank in 2010, the number of individuals subject to administrative law hearings was significantly fewer and the penalties sought in those hearings were significantly less than they are today.<sup>29</sup> Before Dodd-Frank, the SEC could only seek monetary penalties—its main enforcement mechanism—in front of ALJs if the individual or entity was registered with the SEC.<sup>30</sup> Congress limited SEC ALJs' powers in this way because it worried that jurisdiction over non-registered entities and individuals might encourage the SEC to increasingly bring enforcement actions in a venue that lacked Article III judge oversight.<sup>31</sup> Instead, the SEC was forced to proceed in federal district court against non-registered entities and individuals.<sup>32</sup> The passage of Dodd-Frank significantly expanded the types of cases that ALJs are permitted to hear and the penalties available to these judges.<sup>33</sup>

Accordingly, the SEC's Division of Enforcement increasingly turned to ALJs post-Dodd Frank because of the convenience, increased chance of success, and enhanced power of these judges.<sup>34</sup> Prior to Dodd-Frank, the SEC brought around 60% of its enforcement actions in front of ALJs.<sup>35</sup> This percentage has jumped to over 80% of post-Dodd Frank enforcement actions.<sup>36</sup> Not only has the Division of Enforcement routinely turned to administrative law hearings, but also, “[a]ccompanying this increase in the use of administrative proceedings

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28. *See id.* (highlighting increased industry discontent through constitutional challenge and criticism arising from the increased use of ALJs); *see also* Hardy et al., *supra* note 22, at 1–2 (discussing the recent trend toward using SEC ALJs and dissatisfaction toward this trend).

29. *See* Jones, *supra* note 24, at 516 (detailing the expanded administrative power of the SEC under Dodd-Frank, especially SEC's expanded authority to pursue penalties against non-regulated entities).

30. *See id.* at 512 (detailing SEC rights to seek monetary penalties in administrative hearings).

31. *Id.*

32. *See* 15 U.S.C. § 78u-1(a) (2012) (requiring the SEC to seek monetary penalties against non-registered entities and individuals in federal court).

33. *See* Jones, *supra* note 24, at 516–17 (detailing increased cases and penalties year over year since the passage of Dodd-Frank).

34. *See id.* at 517–20 (discussing the different factors that have led the SEC to increasingly resort to the use of administrative proceedings); *see also* Hardy et al., *supra* note 22 (discussing the increased trend of SEC enforcement actions proceeding in front of ALJs).

35. Sara Gilley et al., *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>.

36. *Id.*

has been a concomitant increase in the SEC's success rate in enforcement actions, with the Commission winning 90% of its administrative proceedings and only 69% of its district court cases.<sup>37</sup> Unsurprisingly, defendants in SEC enforcement actions brought before ALJs have expressed growing discontent in recent years over the constitutionality of these proceedings.<sup>38</sup> Lately, at least some of these arguments have gained traction.<sup>39</sup>

In recent federal district court challenges to the constitutionality of SEC ALJs, courts have primarily responded in two ways.<sup>40</sup> In one line of cases,<sup>41</sup> federal district court judges have allowed immediate constitutional challenges to SEC ALJs, despite the presence of an ongoing SEC administrative proceeding.<sup>42</sup> In the other, federal district courts have rejected these challenges, instead requiring the administrative proceeding to finish before a constitutional challenge can be brought.<sup>43</sup> The primary divide between these two lines of cases lies in their respective interpretations of the three-prong *Thunder Basin* test, which was developed to determine whether a constitutional claim should receive immediate district court review or whether the administrative proceeding must first come to completion.<sup>44</sup>

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37. Hardy et al., *supra* note 22, at 1.

38. *See id.* (detailing the increase in constitutional challenges to SEC administrative proceedings).

39. *Id.*

40. *See Jones, supra* note 24, at 520.

41. This note will focus primarily on the first line of cases and will only sparingly discuss the latter.

42. *See e.g., Duka v. U.S. SEC*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605, at \*1–2 (S.D.N.Y. Aug. 12, 2015) (order granting preliminary injunction); *see also Hill v. SEC*, 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822, at \*54–55 (N.D. Ga. June 8, 2015) (order granting preliminary injunction); *see also Gray Fin. Grp., Inc. v. SEC*, 1:15-CV-0492-LMM, 2015 U.S. Dist. LEXIS 131792, at \*1–2 (N.D. Ga. Aug. 4, 2015) (order granting preliminary injunction).

43. *See e.g., Jarkesy v. U.S. SEC*, 48 F. Supp. 3d 32, 34 (D.D.C. 2014) (affirming the SEC's motion to dismiss for lack of subject jurisdiction because the administrative law proceeding must come to completion before a constitutional challenge can be heard); *see also Chau v. U.S. SEC*, 72 F. Supp. 3d 417, 437 (S.D.N.Y. 2014) (affirming the SEC's motion to dismiss for lack of subject jurisdiction because the administrative law proceeding must come to completion before a constitutional challenge can be heard); *see also Bebo v. SEC*, 799 F.3d 765, 767 (7th Cir. 2015) (affirming the SEC's motion to dismiss for lack of subject jurisdiction because the administrative law proceeding must come to completion before a constitutional challenge can be heard).

44. *See Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 212–13 (1994) (precluding district court jurisdiction over a pre-enforcement challenge after considering three factors); *see generally Duka*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605 (S.D.N.Y. Aug.

According to the *Thunder Basin* test, constitutional claims will receive immediate review if: (1) “a finding of preclusion could foreclose all meaningful judicial review;” (2) the claims are “wholly collateral to [the] statute’s review provisions;” and (3) the claims are “outside the agency’s expertise.”<sup>45</sup> In both lines of cases, much of the debate has focused on the first prong of the test.<sup>46</sup> In requiring the administrative proceeding to come to completion first, those federal district courts have held that a finding of preclusion would not foreclose all meaningful judicial review because defendants are able to appeal any ALJ ruling to federal district court.<sup>47</sup> Contrarily, other courts have allowed immediate review because “delayed judicial review here will cause an allegedly unconstitutional *process* to occur.”<sup>48</sup> Strong policy considerations exist for allowing immediate review of the constitutional claims.<sup>49</sup> By delaying review, even defendants who eventually prevail on the merits will likely incur substantial harm given that the defendants’ clients and business opportunities would most likely have vanished, leaving defendants little reason to continue with the challenge.<sup>50</sup> Even for those who do not prevail on the merits, such a delay causes substantial harm in its failure to provide an adequate resolution of constitutional interests. Regardless of whether immediate judicial review is allowed, the constitutional concerns remain and must be addressed.

### III. THE APPOINTMENT OF SEC ADMINISTRATIVE LAW JUDGES

#### A. *The appointment process and procedural powers of SEC ALJs pre- and post-Dodd Frank*

The central constitutional concern over the appointment of SEC

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12, 2015) (order granting preliminary injunction); *Jarkesy*, 48 F. Supp. 3d 32, 34 (D.D.C. 2014) (affirming the SEC’s motion to dismiss for lack of subject jurisdiction because the administrative law proceeding must come to completion before a constitutional challenge can be heard).

45. *Thunder Basin Coal Co.*, 510 U.S. at 207, 212–13.

46. See Jones, *supra* note 24, at 520 (discussing the difficulty respondents have in bringing a successful district court challenge to SEC ALJs under the *Thunder Basin* test).

47. *Bebo*, 799 F.3d at 767.

48. Hill v. SEC, 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822, at \*22 (N.D. Ga. June 8, 2015) (order granting preliminary injunction).

49. Jones, *supra* note 24, at 522.

50. *Id.*



ALJs focuses on whether these officials are considered “inferior officers” or mere employees under the Appointments Clause of Article II of the United States Constitution.<sup>51</sup> If SEC ALJs are mere employees, then they could continue to be hired through the process the SEC currently follows.<sup>52</sup> Historically, ALJs across executive agencies have been considered mere employees and hired through a process outside the scope of the Appointments Clause.<sup>53</sup> This classification rests on the duties that ALJs have traditionally been authorized to perform.<sup>54</sup> For example, ALJs have typically been confined to “oversee[ing] adversarial proceedings, rul[ing] on evidentiary questions, regulat[ing] the course of the hearing, and mak[ing] decisions,” activities representing far less an exercise of power than inferior officers generally wield.<sup>55</sup>

In contrast with the traditional classification of ALJs as mere employees, if SEC ALJs were deemed “inferior officers,” they would need to be constitutionally appointed pursuant to the Appointments Clause.<sup>56</sup> The Appointments Clause states:

[The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and 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.<sup>57</sup>

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51. See *Duka v. U.S. SEC*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605, at \*3 (S.D.N.Y. Aug. 12, 2015) (asserting that the key success to *Duka*’s claims rest on whether SEC ALJs are classified as inferior officers).

52. See SEC’s Resp. to Order, *Timbervest v. Securities and Exchange Commission*, No. 3-15519 (June 4, 2015) <https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf> (responding to SEC Commission’s order for an affidavit and any supporting materials “setting forth the manner in which administrative law judge (ALJ) Cameron Elliot and Chief ALJ Brenda Murray were hired, including the method of selection and appointment”).

53. See Zaring, *supra* note 5, at 10–11 (discussing the traditional use of agency ALJs and the broad powers they’ve been given).

54. *Id.*

55. *Id.* at 11.

56. *Duka*, 2015 U.S. Dist. LEXIS 106605 at \*5-6.

57. U.S. CONST. art II, § 2, cl. 2.

Thus, there are two classes of officers contemplated by the Appointment Clause: (1) principal officers, who are nominated by the President with the advice and consent of the Senate, and (2) inferior officers, who may be appointed by the President, Courts of Law, or Heads of the Departments.<sup>58</sup> Any individual “exercising significant authority” under U.S. law is considered an “Officer of the United States” and must be appointed pursuant to the Appointments Clause.<sup>59</sup> The Appointments Clause also applies to all agency officers, “including those whose functions are ‘predominately quasi judicial and quasi legislative’ and regardless of whether the agency officers are ‘independent of the Executive in their day-to-day operations.’”<sup>60</sup> The Supreme Court has broadly construed the definition of an inferior officer and has required a wide range of individuals to be appointed pursuant to the Appointments Clause.<sup>61</sup> For example, “[the Supreme] 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 [Tax Court special trial] judges, and the general counsel for the Transportation Department are inferior officers.”<sup>62</sup> The Supreme Court has continually recognized a broad range of individuals as “inferior officers” because the Appointments Clause “not only guards against [separation of powers] encroachment but also preserves another aspect of the Constitution’s structural integrity by preventing the diffusion of the appointment power.”<sup>63</sup> Consequently, if SEC ALJs are found to “exercis[e] significant authority pursuant to the laws of the United States,” then they would need to be appointed consistent with the Appointments Clause.<sup>64</sup>

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58. See *Buckley v. Valeo*, 424 U.S. 1, 132 (1976) (describing historical understanding of the Appointments Clause).

59. *Freytag v. Comm’r of Internal Revenue*, 501 U.S. 868, 881 (1991) (holding that Tax Court STJs were inferior officers under the Appointments Clause).

60. *Hill v. SEC*, 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822, at \*43–44 (N.D. Ga. June 8, 2015) (discussing the officials required to be appointed pursuant to the Appointments Clause) (quoting *Buckley*, 424 U.S. at 133).

61. See Kent Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 812 (2013) (citing *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 540 (2010) (Breyer, J., dissenting) (giving examples of the various individuals classified as “inferior officers”).

62. Barnett, *supra* note 61, at 812.

63. *Freytag*, 501 U.S. at 878.

64. *Id.* at 881.

Prior to the passage of Dodd-Frank in 2010, SEC ALJs performed tasks “in an area sufficiently removed from the administration and enforcement of the public law” similar to that of other agency ALJs, so that they were not considered “inferior officers” subject to the Appointments Clause.<sup>65</sup> They performed, and continue to perform, many quasi-judicial tasks including ruling on evidentiary questions, issuing subpoenas, and overseeing adversarial proceedings.<sup>66</sup> More importantly, prior to Dodd-Frank they were largely limited to regulating and hearing proceedings involving entities regulated by the SEC.<sup>67</sup> Thus, before Dodd-Frank, SEC ALJs did not exercise enough power or influence to classify them as “inferior officers” and require their constitutional appointment and, accordingly, were appointed in a manner consistent with their designation as mere employees.<sup>68</sup> The process for their hiring followed a similar process to the one followed today:

As do other agencies, the Commission hires its ALJs through this OPM process.<sup>69</sup> When the Commission seeks to hire a new ALJ, Chief ALJ Murray obtains from OPM a list of eligible candidates; a selection is made from the top three candidates on that list. *See* 5 U.S.C. §§ 3317, 3318; 5 C.F.R. §§ 332.402, 332.404, 930.204(a). Chief ALJ Murray and an interview committee then make a preliminary selection from among the available candidates. Their recommendation is subject to final approval and processing by the Commission’s Office of

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65. *See Buckley v. Valeo*, 424 U.S. 1, 139 (1976) (describing that individuals exercising non-judicial and non-executive functions are not considered inferior officers under the Appointments Clause).

66. Zaring, *supra* note 5, at 11.

67. *See Jones*, *supra* note 24, at 512 (noting that Congress intentionally left the power to regulate unregistered individuals from previous legislation).

68. U.S. Dep’t of Justice Resp. to Ct.’s Inquiry at 1, *Duka v. Sec. and Exch. Comm’n*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605 (June 15, 2015) <http://blogs.reuters.com/alison-frankel/files/2015/06/dukavsec-secanswtoberman.pdf> (describing the manner in which SEC ALJs are currently appointed).

69. “OPM (“The Office of Personnel Management”) is responsible for the successful management of human capital, not only within our own organization, but also across every Federal agency. We assist Federal agencies in hiring new employees, provide Federal investigative services for background checks, create training programs to develop tomorrow’s leaders — and much more.” U.S. OFFICE OF PERS. MGMT., OUR MISSION, ROLE & HISTORY <https://www.opm.gov/about-us/our-mission-role-history/what-we-do/> (last visited Oct. 31, 2015); *See* 5 U.S.C. § 3105; 5 C.F.R. § 930.201(f).

Human Resources . . . . As for earlier hires, it is likely the Commission employed a similar, if not identical, hiring process.<sup>70</sup>

SEC ALJs, alongside ALJs across all executive agencies, are appointed through a process not involving Presidential, Judicial, or Commission oversight, but instead appointed through the Office of Personnel Management.<sup>71</sup> While this appointment process was sufficient for SEC ALJs prior to Dodd-Frank's passage, it is now called into question by ALJs expanded judicial powers post-Dodd-Frank.<sup>72</sup>

Dodd-Frank tremendously expanded the role and influence of SEC ALJs.<sup>73</sup> While “the authority of ALJs to exercise broad discretion in the administration of their duties has been established by the Supreme Court,”<sup>74</sup> the increased quasi-judicial role of SEC ALJs post-Dodd-Frank transformed the body into a group of “inferior officers” that should be constitutionally appointed.<sup>75</sup> As the Supreme Court stated in *Buckley v. Valeo*:

Congress may undoubtedly . . . provide such method of appointment to those “offices” as it chooses. But Congress’ power under that Clause is inevitably bounded by the express language of Art. II, s. 2, cl. 2, and unless the method it provides comports with the

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70. See SEC’s Resp. to Order, *Timbervest v. Sec. and Exch. Comm’n*, No. 3-15519 (June 4, 2015) <https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf> (responding to SEC Commission’s order for an affidavit and any supporting materials “setting forth the manner in which administrative law judge Cameron Elliot and Chief ALJ Brenda Murray were hired, including the method of selection and appointment”).

71. *Id.*

72. See Frankel, *supra* note 21 (examining recent challenges to the ALJ appointment process).

73. See Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 929P, 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012) (expanding the penalties available to SEC ALJs in administrative hearings); Dodd-Frank, § 925, 15 U.S.C. §§ 78o, 78o-4, 78q-1, 80b-3 (2012) (extending SEC ALJ jurisdiction to unregistered entities and persons).

74. Zaring, *supra* note 5, at 10.

75. See generally *Duka v. U.S. SEC*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605, at \*3–4 (S.D.N.Y. Aug. 12, 2015) (order granting preliminary injunction); *Hill v. SEC*, 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822, at \*44–45 (N.D. Ga. June 8, 2015) (order granting preliminary injunction); *Gray Fin. Grp., Inc. et al v. SEC*, 1:15-CV-0492-LMM, 2015 U.S. Dist. LEXIS 131792, at \*44–46 (N.D. Ga. Aug. 4, 2015) (order granting preliminary injunction).

latter, the holders of those offices will not be ‘Officers of the United States.’ They may, therefore, properly perform duties only . . . in an area sufficiently removed from the administration and enforcement of the public law as to permit their being performed by persons not ‘Officers of the United States.’<sup>76</sup>

In light of the expansion of SEC ALJs, both jurisdictional and disciplinary powers post-Dodd Frank, it can hardly be said that SEC ALJs perform their duties in an area sufficiently removed from the administration and enforcement of the public law.<sup>77</sup> Prior to Dodd-Frank, SEC ALJs were limited to imposing civil penalties in enforcement actions involving registered entities and individuals.<sup>78</sup> While SEC ALJs could hear proceedings involving non-regulated individuals prior to Dodd-Frank, the penalties they could impose were limited to temporary and permanent cease-and-desist orders, which pale in comparison to the force of monetary penalties.<sup>79</sup> Dodd-Frank granted SEC ALJs the authority to impose monetary penalties against any individual who “is violating, has violated, or is about to violate any provision of this [title] [15 USC §§ 77a et seq.], or any rule or regulation thereunder.”<sup>80</sup> Thus, SEC ALJs’ authority grew from limited control over a very small group to expansive

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76. *Buckley v. Valeo*, 424 U.S. 1, 138–39 (1976) (ruling that inferior officers must be exclusively appointed by means of the Appointment Clause).

77. See Dodd-Frank, § 929P, 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012) (expanding the penalties available to SEC ALJs in administrative hearings); Dodd-Frank, § 925, 15 U.S.C. §§ 78o, 78o-4, 78q-1, 80b-3 (2012) (extending SEC ALJ jurisdiction to unregistered entities and persons).

78. See *Jones*, *supra* note 25, at 516 (explaining increased power given to the SEC after Dodd-Frank, especially in giving SEC authority to pursue penalties against “non-registered entities”). SEC registration is required for most brokers and dealers. U.S. SEC. AND EXCH. COMM’N, GUIDE TO BROKER-DEALER REGISTRATION (Apr. 2008) <http://www.sec.gov/divisions/marketreg/bdguide.htm#II>. The SEC defines a broker as “any person engaged in the business of effecting transactions in securities for the account of others,” while a dealer is “any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise.” *Id.* In order to register, these individuals and entities must: file a Form BD, and the SEC subsequently must approve the individual or entity’s registration; the individual or entity must become a member of a Self-Regulatory Organization; must become a member of the Securities Investor Protection Corporation; must comply with all applicable state requirements; and its “associated persons” must satisfy all applicable qualification requirements. *Id.* For further information on individuals required to register and the registration process can be found at [sec.gov](http://sec.gov). *Id.*

79. See *Jones*, *supra* note 24, at 512 (detailing the changes to SEC ALJs that resulted from Dodd-Frank’s enactment).

80. Dodd-Frank, § 929P, 15 U.S.C. §§ 77h-1(a) (2012).

control over any and all individuals, including foreign entities that engage in securities fraud.<sup>81</sup> With the expansion of its jurisdiction, sanctions that may be delivered by ALJs including cease-and-desist orders, disbarments, and large civil penalties have become even more powerful as they can adversely affect a much larger group of people.<sup>82</sup>

Furthermore, Dodd-Frank also brought significant increases in the SEC ALJs' disciplinary power.<sup>83</sup> In addition to imposing civil penalties on unregulated individuals, an order of disgorgement can also be added to any proceeding in which the SEC could impose a penalty.<sup>84</sup> The SEC defines disgorgement as "the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible."<sup>85</sup> While maximum civil penalties for individuals and corporations remain relatively small,<sup>86</sup> the addition of disgorgement can lead to enormous penalties. For example, in 2014, the SEC collected nearly \$1.4 billion in penalties.<sup>87</sup> Yet during that same period, the SEC collected over double that amount, approximately \$2.8 billion, in disgorgement of illegal profits.<sup>88</sup> Further, Dodd-Frank gave the SEC more power "to impose secondary liability for employees aiding in their company's illegal activity . . . [and] more power to regulate foreign private accounting firms."<sup>89</sup> Thus, the considerable increase in power SEC ALJs have enjoyed post-Dodd-Frank, combined with the numerous quasi-judicial duties they perform, casts serious doubt on their designation as mere employees.

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81. See Zaring, *supra* note 5, at 17 (discussing SEC ALJs expanded jurisdiction over non-registered entities); "[T]he fact that SEC ALJs now have the power to impose strong civil sanctions. . . on individuals whose engagement with the agency's regulatory scheme is limited to their mere participation in the capital markets, raises the question about whether agency judges have been given the sort of judicial authority that belongs with Article III judges alone." *Id.* at 30, n.127.

82. See *id.* at 30, n.127 (noting SEC ALJs increased powers post-Dodd Frank).

83. Dodd-Frank, § 929P, 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012) (expanding the penalties available to SEC ALJs in administrative hearings);

84. *Id.* at 15.

85. SEC. AND EXCH. COMM'N, AGENCY FINANCIAL REPORT: FISCAL YEAR 2014, 66 n. 9, <http://www.sec.gov/about/secafr2014.shtml> (defining disgorgement and other key terms).

86. See The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, 15 U.S.C. § 78u-2(e) (1990) (providing the civil penalties SEC ALJs can enforce on violators).

87. Zaring, *supra* note 5, at 16.

88. *Id.*

89. Jones, *supra* note 24, at 516.

B. *Comparison of SEC ALJs with Federal Tax Court's Special Trial Judges ("STJs")*

Rather than performing functions similar to other agencies' ALJs, SEC ALJs perform almost identical functions to those of the federal Tax Court's STJs and, as a result, should be appointed in the same manner. In the 1991 case *Freytag v. Commissioner*, the Supreme Court held that an STJ of the Tax Court was an "inferior officer" under the Appointments Clause.<sup>90</sup> In arriving at its decision, the Supreme Court focused on characteristics that are strikingly similar to those of the SEC's ALJs:

The office of special trial judge is "established by Law," Art. II, § 2, cl. 2, and the duties, salary, and means of appointment for that office are specified by statute . . . . These characteristics distinguish special trial judges from special masters, who are hired by Article III courts on a temporary, episodic basis, whose positions are not established by law, and whose duties and functions are not delineated in a statute.

Furthermore, special trial judges perform more than ministerial tasks.

They take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders. In the course of carrying out these important functions, the special trial judges exercise significant discretion.<sup>91</sup>

As a result of these duties, the Supreme Court ruled that Tax Court STJs were not mere employees, but instead were inferior officers that must be appointed in accordance with the Appointments Clause.<sup>92</sup>

SEC ALJs perform almost identical duties to those performed by the STJs in *Freytag* and, therefore, exercise significant discretion. Like the Tax Court's STJs, "the office of an SEC ALJ is established by law, and the 'duties, salary, and means of appointment for that office are specified by statute.'"<sup>93</sup> Additionally, ALJs are permanent employees and can only be removed for good cause similar to the removal process for STJs.<sup>94</sup> While ALJs do not have final order authority because all

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90. *Freytag v. Comm'r of Internal Revenue*, 501 U.S. 868, 882 (1991) (considering whether Tax Court STJs were inferior officers under the Appointments Clause).

91. *Freytag*, 501 U.S. at 881–82 (quoting U.S. CONST. art. II, § 2, cl. 2).

92. *Id.* at 880–82.

93. *Hill v. U.S. Sec. & Exch. Com.*, No. 1:15–CV–1801–LMM, 2015 U.S. Dist. LEXIS 74822, at \*17 (N.D. Ga. 2015) (quoting *Freytag*, 501 U.S. at 881–82) (granting a preliminary injunction).

94. *Zaring*, *supra* note 5, at 13.

orders are subject to the SEC Commissions', they can issue cease-and-desist orders, impose large fines, and issue injunctions.<sup>95</sup> These formidable powers can have lasting impacts on both individuals and the industry as a whole.<sup>96</sup> As one scholar noted, "[t]he cease and desist, let alone the disbarment, power matters because it can be used for future injunctions of indeterminate length. Refusing to permit a person the right to practice before the SEC [can] mean, for brokers, accountants, and others, that their careers are over."<sup>97</sup>

By increasingly utilizing ALJs to resolve disputes, the SEC places policy-making decisions in the hands of a non-appointed regulatory body, which allows ALJs to exercise "significant discretion" and hold large influence over the industry as a whole without the executive oversight generally required over such positions.<sup>98</sup> Therefore, SEC ALJs' newly-created and significantly expanded powers and authority should require their appointment pursuant to the Appointments Clause.

### C. *The SEC's position that ALJs are mere employees*

In response to multiple challenges in federal court to the constitutionality of the appointment of its ALJs, the SEC has defended its process for hiring its ALJs by arguing that the ALJs are mere employees and not "inferior officers."<sup>99</sup> It argues that its ALJs are mere employees because SEC ALJs technically lack enforcement power and authority to act independently.<sup>100</sup> While some courts have opined that SEC ALJs

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95. *Id.* at 9.

96. *Id.* at 15.

97. *Id.*

98. *Id.* at 17.

99. *See e.g.*, U.S. Dep't of Justice Resp. to Ct.'s Inquiry at 1–3, *Duka v. Sec. & Exch. Comm'n*, 103 F. Supp. 3d 382 (S.D.N.Y. 2015) (No. 15 Civ. 357(RMB)(SN)), <http://blogs.reuters.com/alison-frankel/files/2015/06/dukavsec-secanswtoberman.pdf>; SEC's Resp. to Order, *Timbervest, LLC v. Sec. & Exch. Comm'n*, 2015 WL 7597428, (N.D. Ga. Aug. 4, 2015) (No. 1:15-CV-2106-LMM), <https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf> (responding to SEC Commission's order for an affidavit and any supporting materials "setting forth the manner in which administrative law judge Cameron Elliot and Chief ALJ Brenda Murray were hired, including the method of selection and appointment"); Dep't of Justice Supp. Briefing at 1–3, *Tilton v. Sec. & Exch. Comm'n*, 2015 WL 4006165, (S.D.N.Y. 2015) (No. 15–CV–2472 (RA)), <http://blogs.reuters.com/alison-frankel/files/2015/06/tiltonvsec-seconwhyaljsnotinferiorofficers.pdf>.

100. U.S. Dep't of Justice Resp. to Ct.'s Inquiry, *supra* note 99, at 2.



closely resemble Tax Court STJs, the SEC has repeatedly stated that they are far less powerful:

SEC ALJs powers pale in comparison [to Tax Court STJs]. For example, their power to punish contemptuous conduct is limited and does not include any ability to impose fines or imprisonment. And while SEC ALJs may issue subpoenas, in cases of noncompliance, the agency would need to seek an order from a federal district court to compel compliance. Moreover, SEC ALJs are subject to the Commission's plenary authority "over the course of [the] administrative proceeding . . . both before and after the issuance of the initial decision." They are also subordinate to the agency on "matters of policy and interpretation of law". In sum, their authority in no way approaches that of STJs, even if they perform some of the same basic duties.<sup>101</sup>

According to the SEC, its ALJs are more comparable to employees of other agencies and, thus, are not powerful enough to be considered "inferior officers."<sup>102</sup>

While the SEC argues that the Commission's final authority over any administrative proceeding prevents ALJs from being considered inferior officers, its arguments are ultimately unconvincing for two reasons. First, the SEC and the D.C. Circuit Court have misinterpreted important precedent.<sup>103</sup> Second, the expansion of ALJs' other powers post-Dodd-Frank now requires them to be appointed pursuant to the Constitution. In arguing that SEC ALJs are mere employees, the SEC has cited the U.S. Court of Appeals for the D.C. Circuit's 2000 decision in *Landry v. FDIC*, which considered whether Federal Deposit Insurance Corporation ("FDIC") ALJs were inferior officers under the Appointments Clause.<sup>104</sup> In concluding that FDIC ALJs are not inferior officers, the D.C. Circuit's majority opinion interpreted *Freytag*—despite express language to the contrary—as finding the absence of final decision power to be dispositive in determining whether an individual was an

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101. U.S. Dep't of Justice Supp. Briefing, *supra* note 99, at 2 (internal citations omitted).

102. *Id.*; U.S. Dep't of Justice Resp. to Ct.'s Inquiry, *supra* note 99, at 2.

103. *Hill v. U.S. Sec. & Exch. Com.*, No. 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822, at \*50 (N.D. Ga. 2015) ("[T]his Court concludes that the Supreme Court in *Freytag* found that the STJs powers—which are nearly identical to the SEC ALJs here—were independently sufficient to find that STJs were inferior officers.).

104. See *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000) (ruling that FDIC ALJs are not inferior officers under the Appointments Clause).

inferior officer or not.<sup>105</sup> The SEC agrees with the *Landry* court's interpretation in arguing, "the Court's discussion of the special trial judges' power to render final decisions in certain cases 'would have been quite unnecessary if the purely recommendatory powers were fatal in themselves.'"<sup>106</sup>

Yet, contrary to the D.C. Circuit's majority opinion and the SEC's interpretation, the *Freytag* court did not place nearly as much emphasis on STJs' final decision power.<sup>107</sup> In fact, "[o]nly after it concluded STJs [of the tax court] were inferior officers did *Freytag* address the STJs' ability to issue a final order; the STJs' limited authority to issue final orders was only an additional reason, not *the* reason [for finding that STJs were inferior officers]."<sup>108</sup> Rather than finding final decision power dispositive, the Court focused on the degree of authority STJs exercised in comparison with other employees.<sup>109</sup> It found that the degree of authority exercised by STJs was "so 'significant' that it was inconsistent with the classifications of 'lesser functionaries' or employees'."<sup>110</sup> Contrary to the DC Circuit's majority opinion in *Landry*, the Supreme Court in *Freytag* held that the lack of final authority power was not dispositive and that relying on such an argument "ignores the significance of the duties and discretion that special trial judges possess."<sup>111</sup> A reviewing court should instead focus on the extent of quasi-judicial and quasi-legislative power the individual exercises.<sup>112</sup> In accordance with this view, the concurrence in *Landry* recognized the majority's faulty reasoning in holding that FDIC ALJs are not "inferior

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105. *Landry*, 204 F.3d at 1133–34.

106. Defendant-Appellant's Reply Brief at 32, *Hill v. U.S. Sec. & Exch. Com.*, 2015 U.S. Dist. LEXIS 74822 (N.D. Ga. 2015) (No. 15-12831) (quoting *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000)).

107. See *Hill*, 2015 U.S. Dist. LEXIS 74822, at \*43–46 ("The Court finds that based upon the Supreme Court's holding in *Freytag*, SEC ALJs are inferior officers.").

108. *Id.* at \*50.

109. See *Freytag v. Comm'r of Internal Revenue*, 501 U.S. 868, 881–82 (1991) (considering whether Tax Court STJs were inferior officers under the Appointments Clause).

110. *Freytag*, 501 U.S. at 881 (quoting *Go-Bart Importing Co. v. United States*, 282 U.S. 344, 352–53 (1931)).

111. *Id.*

112. See *id.* at 881–82 (opining that the Court should focus on the true nature of the individual's responsibilities and duties, rather than final decision power); 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 . . .") (internal quotation marks omitted).

officers.”<sup>113</sup> Concurring in part—only because he believed the plaintiff has suffered no prejudicial error—Circuit Judge Randolph directly rejected the majority’s characterization of FDIC ALJs as mere employees.<sup>114</sup> Instead, Judge Randolph opined, “[t]here are no relevant differences between the ALJ in this case and the special trial judge in *Freytag* . . . . The majority attempts to distinguish *Freytag* on two grounds. Neither survives close attention.”<sup>115</sup> Circuit Judge Randolph was consequently unconvinced by the majority’s argument that the *de novo* review process followed by the Commission and the ALJs lack of final decision power were sufficient to render FDIC ALJs mere employees.<sup>116</sup> Further highlighting the disagreement with the DC Circuit’s analysis is the express statement of U.S. District Court Judge May of the Northern District of Georgia: “*Freytag* mandates a finding that the SEC ALJs exercise ‘significant authority’ and are thus inferior officers.”<sup>117</sup>

#### IV. REMOVAL OF SEC ADMINISTRATIVE LAW JUDGES

##### A. *Recent limitations by the Supreme Court on the President’s ability to remove executive officers at will.*

From the founding of the United States, the power to remove inferior officers has been considered vital to the full and successful exercise of executive power.<sup>118</sup> The President’s ability to remove executive officers at his discretion is primarily derived from two places within the Constitution.<sup>119</sup> First, the Vesting Clause gives the President

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113. See *Landry v. FDIC*, 204 F.3d 1125, 1140–41 (D.C. Cir. 2000) (Randolph, J., concurring in part and concurring in the judgment).

114. *Id.* at 1140–41.

115. *Id.* at 1141.

116. *Id.* at 1143.

117. *Hill v. SEC*, No. 1:15–CV–1801–LMM, 2015 U.S. Dist. LEXIS 74822, at \*50 (N.D. Ga. June 8, 2015) (granting a preliminary injunction).

118. “In light of the impossibility that one man should be able to perform all the great business of the State, the Constitution provides for executive officers to assist the supreme Magistrate in discharging the duties of his trust. Since 1789, the Constitution has been understood to empower the President to keep these officers accountable—by removing them from office, if necessary.” *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 483 (2010) (internal quotation marks and citations omitted) (finding the limitations on removal of Board members unconstitutional under article II).

119. See U.S. CONST. art. II, § 2, cl. 1 (vesting the entire executive power in the President); U.S. CONST. art. II, § 3 (mandating that the President “shall take care that the laws be faithfully

exclusive control over the executive branch in the President.<sup>120</sup> It follows that individuals exercising executive power must be controllable and, ultimately, removable by the President so he can maintain full control over the executive branch.<sup>121</sup> Second, the Take Care clause requires that the President “shall take care that the laws be faithfully executed.”<sup>122</sup> Without full control over executive officers, the President cannot completely guide policy decisions or ensure that laws are properly enforced.<sup>123</sup> As Chief Justice Taft argued in *Myers v. U.S.*:

The power of removal is incident to the power of appointment . . . and when the grant of the executive power is enforced by the express mandate to take care that the laws be faithfully executed, it emphasizes the necessity for including within the executive power as conferred the exclusive power of removal.<sup>124</sup>

While the removal power generally provides the President the ability to remove executive officials at will, it is not an unlimited power.<sup>125</sup> Recent Supreme Court precedent has argued for a rather limited interpretation of the President’s power of removal.<sup>126</sup> Primarily, the Supreme Court’s decisions in *Morrison v. Olson* and *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.* strongly restrict the President’s ability to remove executive officers.<sup>127</sup> In *Morrison*, the Court considered the constitutionality of congressional limits on

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executed”); *see also* *Myers v. U.S.*, 272 U.S. 52, 137–39 (1926) (arguing for an unlimited presidential removal power over certain subordinate executive officials from, among other sources, the Article II Vesting Clause and the Take Care Clause).

120. U.S. CONST. art. II, § 2, cl. 1 (vesting the entire executive power in the President).

121. *Myers*, 272 U.S. at 137–39.

122. U.S. CONST. art. II, § 3.

123. *Myers*, 272 U.S. at 121–22.

124. *Id.* at 122.

125. *See Morrison v. Olson*, 487 U.S. 654, 691–92 (1988) (ruling that congressional limits on removal would be determined by a functional test, instead of rigid criteria).

126. *See Morrison*, 487 U.S. at 691–92. *But see id.* at 697–734 (Scalia, J., dissenting) (arguing for unlimited presidential removal power).

127. *See id.* at 691–92 (ruling that congressional limits on removal would be determined by a functional test, instead of rigid criteria); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 508 (2010) (finding the limitations on removal of Board members unconstitutional under article II).

presidential removal power.<sup>128</sup> Writing for the majority, Chief Justice Rehnquist stated that removal limits would be upheld as long as they did not “unduly trammel on executive authority” or “impermissibly burden the President’s power to control or supervise [independent officers].”<sup>129</sup> Instead of a formal set of rules, Chief Justice Rehnquist set forth a functional test: “[t]he analysis contained in our removal cases is designed not to define rigid categories . . . but to ensure that Congress does not interfere with the President’s exercise of the ‘executive power’ and his constitutionally appointed duty to ‘take care that the laws be faithfully executed’ under Article II.”<sup>130</sup>

Similarly, in *Free Enterprise*, the Court also used a functional test to determine the constitutionality of Congressional removal restrictions.<sup>131</sup> In determining whether restrictions on the removal of Public Company Accounting Oversight Board (“PCAOB”) members was constitutional, the Court focused on whether the removal restrictions were structured so as to impede the President’s constitutional duties by “depriv[ing] the President of adequate control over the Board.”<sup>132</sup> Furthermore, the Court specifically looked to determine whether “the President [may] be restricted in his ability to remove a principal officer, who is in turn restricted in his ability to remove an inferior officer, even though that inferior officer determines the policy and enforces the laws of the United States.”<sup>133</sup> Ultimately, the Court held that the removal restrictions were unconstitutional because the PCAOB enjoyed expansive executive powers and promulgated rules and procedures for an entire industry.<sup>134</sup>

Consequently, courts reviewing the constitutionality of removal restrictions on SEC ALJs courts must read *Morrison* and *Free Enterprise* together and apply the prevailing functional test espoused in those cases. Whether such a challenge will succeed turns on “whether the removal restrictions are of such a nature that they impede the President’s ability to perform his constitutional duty.”<sup>135</sup>

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128. *Morrison*, 487 U.S. at 691–92.

129. *Id.*

130. *Id.* at 689–90.

131. *Free Enter. Fund*, 561 U.S. at 535–36.

132. *Id.* at 508.

133. *Id.* at 483–84.

134. *Id.* at 492–508.

135. *Morrison*, 487 U.S. at 691 (ruling that congressional limits on removal would be

B. *The constitutionality of the SEC's multi-tiered structure for removing SEC ALJs*

While SEC ALJs enjoy multiple levels of tenure protection under the agency's removal process, the restrictions on their removal are most likely constitutional.<sup>136</sup> Similar to the removal process of PCAOB members in *Free Enterprise*, the removal process for SEC ALJs follows a multi-tiered structure that extensively insulates ALJs from removal.<sup>137</sup> The U.S. District Court for the Southern District of New York's opinion in *Duka v. SEC* discussed this complicated process for removal:

All ALJs, including SEC ALJs, are removable from employment by their respective agency heads (in this case, the *Commission*) but only for "good cause." Good cause must be "established and determined" by the Merit Systems Protections Board ("MSPB"), an independent federal agency which handles federal employee appeals of adverse employment actions. The SEC Commissioners, in turn, "cannot themselves be removed by the President except [for] inefficiency, neglect of duty, or malfeasance of office."<sup>138</sup>

Thus, courts recognized two-layers of tenure protection for SEC ALJs: (1) they may only be removed for cause, and (2) their superiors are also only removable for cause.<sup>139</sup> While clearly protected from removal by two barriers, SEC ALJs are debatably even further distanced from removal by a third barrier that is concerning.<sup>140</sup> In addition to SEC ALJs and Commissioners, the members of the MSPB are also only removable for good cause.<sup>141</sup> Therefore, SEC ALJs can only be removed for good cause by commissioners, who can only be removed for good cause by

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determined by a functional test, instead of rigid criteria).

136. See e.g., *Duka v. U.S. Sec. & Exch. Com.*, 15 Civ. 357 (RMB) (SN), 2015 U.S. Dist. LEXIS 106605, at \*6–7 (S.D.N.Y. Aug. 12, 2015) (order granting preliminary injunction).

137. Zaring, *supra* note 5, at 32–33.

138. *Duka v. Sec. & Exch. Comm'n.*, 103 F. Supp. 3d 382, 387 (S.D.N.Y. 2015) (quoting *Free Enter. Fund*, 561 U.S. at 487) ((denying plaintiff's request for a preliminary injunction) (internal citations omitted) (emphasis added)).

139. *Id.* at 393–96.

140. *Id.* at 32.

141. Zaring, *supra* note 5, at 32.

MSPB members who, in turn, can only be removed for good cause themselves. In effect, this triple layer of protection from removal limits executive authority such that the President “has very little ability to enact his preferred security regulation policy.”<sup>142</sup>

While multiple levels of protection separate SEC ALJs from removal by the President, the relatively narrow scope of their duties and powers cannot sufficiently impede Presidential control to generate a constitutional issue. SEC ALJs do not exercise the broad executive powers that the PCAOB exercised, but, instead, act in a quasi-judicial role within the SEC.<sup>143</sup> They exercise powers that are functionally equivalent to a judge and apply law to the particular facts.<sup>144</sup> Additionally, in *Free Enterprise*, the Court chose to specifically exclude executive agency ALJs from its holding.<sup>145</sup> Interpreting Supreme Court precedent, U.S. District Court Judge Berman of the Southern District of New York concluded, “[t]he upshot is that congressional restrictions upon the President’s ability to remove quasi judicial agency adjudicators are unlikely to interfere with the President’s ability to perform his executive duties.”<sup>146</sup> Consequently, although the layers of protection from removal that SEC ALJs enjoy appear to place substantial restrictions on the President’s ability to enforce his preferred securities law policy, between SEC ALJs’ quasi-judicial role and the Supreme Court’s functional evaluation of removal processes, the current removal process for SEC ALJs is unlikely to be found unconstitutional.

#### V. CONCLUSIONS, IMPLICATIONS ON PAST, PRESENT, AND FUTURE SEC ALJ RULINGS, AND HOW THE CONSTITUTIONAL FLAWS COULD BE FIXED

While the SEC’s current process for removing ALJs is likely constitutional, the process for their appointment is most likely unconstitutional under recent Supreme Court precedent.<sup>147</sup> As Judge

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142. *Id.*

143. *Duka*, 103 F. Supp. 3d at 395 (“This Court finds no basis for concluding, as *Duka* urges, that the statutory restrictions upon the removal of SEC ALJs are ‘so structured as to infringe the President’s constitutional authority.’”).

144. *Id.*

145. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 507 n.10 (2010).

146. *Duka*, 103 F. Supp. 3d at 395.

147. *See generally Morrison v. Olson*, 487 U.S. 654 (1988) (ruling that congressional limits on removal would be determined by a functional test, instead of rigid criteria); *Free*

May stated, “Congress may not ‘decide’ an ALJ is an employee, but then give him the powers of an inferior officer; that would defeat the separation-of-powers protections that Clause was enacted to protect.”<sup>148</sup> Prior to the enactment of Dodd-Frank, SEC ALJs were sufficiently limited in the extent of their quasi-judicial powers so as not to violate the Appointments Clause. Dodd-Frank’s considerable expansion of SEC ALJ powers has since transformed these employees into inferior officers required to be constitutionally appointed. While Congress clearly wanted to expand SEC ALJs’ powers in order to help “promote the financial stability of the United States,”<sup>149</sup> there are constitutional limits on Congress’ ability to alter executive powers and courts must prevent unconstitutional extension.<sup>150</sup> “The Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint.”<sup>151</sup> Dodd-Frank extended SEC ALJs powers beyond that of mere employees, and thus, courts should require their appointment pursuant to the Appointments Clause. Failure to do so will maintain a system where significant power is exercised in a manner contrary to the dictates of the Constitution.

If courts ultimately side with defendants’ recent constitutional challenges to the appointment process of SEC ALJs, there will likely be a significant impact on current and future proceedings, but not on those proceedings already completed.<sup>152</sup> Past proceedings will most likely be exempt from attacks on their validity due to the principle of finality, which states, “[o]nce a judgment has become final, *i.e.*, the time to seek direct review has expired or a petition for *certiorari* has been denied, it typically cannot be attacked collaterally, absent extraordinary circumstances outweighing the presumption in favor of finality.”<sup>153</sup> Further, the fact that the decision-maker was unconstitutionally appointed is not strong enough to outweigh the presumption of finality.<sup>154</sup> “The

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*Enter. Fund*, 561 U.S. 477 (2010).

148. *Hill v. SEC*, 1:15-CV-1801-LMM, 2015 U.S. Dist. LEXIS 74822, at \*51 (N.D. Ga. June 8, 2015) (order granting preliminary injunction).

149. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (stating the intention of the enactment of Dodd-Frank).

150. *Hill*, 2015 U.S. Dist. LEXIS 74822, at \*51.

151. *See Freytag v. Comm’r*, 501 U.S. 868, 880 (1991) (considering whether Tax Court STJs were inferior officers under the Appointments Clause).

152. *Hardy et al.*, *supra* note 22, at 4–7.

153. *Id.* at 4.

154. *See id.* (arguing that individuals voluntarily submitting to past SEC ALJ proceedings



Supreme Court has made clear that even when the adjudicator lacked the power to decide the case, once a judgment has become final, the defect cannot be raised collaterally.<sup>155</sup> Thus, parties who have already received a verdict from an enforcement proceeding in front of SEC ALJs would most likely not be able to bring suit.<sup>156</sup>

While past proceedings would most likely not be affected, a finding of unconstitutionality could significantly impact the plethora of proceedings currently in front of SEC ALJs.<sup>157</sup> If courts found the appointment process unconstitutional, parties to these proceedings could most likely have their administrative proceedings found void.<sup>158</sup> Supreme Court precedent strongly supports the voiding of judgments rendered by improperly appointed adjudicators.<sup>159</sup> Most notably, in 1995 in *Ryder v. United States*, multiple decisions handed down by the Coast Guard Court of Military Review were vacated by the Court because two of the court's officers were appointed improperly under the Appointments Clause.<sup>160</sup> Writing for a unanimous Court, Chief Justice Rehnquist stated, "one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case is entitled to a decision on the merits of the question and whatever relief may be appropriate if a violation indeed occurred."<sup>161</sup> In *Ryder*, the appropriate remedy was to remand the case to the original organization (Coast Guard Court of Military Review) to be reheard by a body appointed in a constitutionally valid manner.<sup>162</sup> Likewise, in *United States v. American-Foreign S.S. Corp.*, the U.S. Court of Appeals for the Second Circuit decision *en banc* was vacated because one of the judges was retired.<sup>163</sup> Again, finding that the decision was made by a constitutionally invalid body, the Supreme Court remanded the case back

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will most likely not be able to challenge the finality of past decisions).

155. *Id.*

156. *Id.*

157. *Id.* at 4–6.

158. *Id.*

159. See generally *Ryder v. U.S.*, 515 U.S. 177 (1995) (holding that decisions by the Coast Guard Court of Military Review were invalid because two members were improperly appointed); *U.S. v. Am.-Foreign S.S. Corp.*, 363 U.S. 685, 691 (1960) (vacating a 2d Circuit *en banc* decision because one of the sitting judges had retired).

160. *Ryder*, 515 U.S. at 188.

161. *Id.* at 182–83.

162. *Id.* at 188.

163. *Am.-Foreign S.S. Corp.*, 363 U.S. at 691.

to the Second Circuit to be heard by a constitutionally valid body.<sup>164</sup> Accordingly, if the Court were to find the appointment of SEC ALJs unconstitutional, the hundreds of proceedings currently under way would need to be remanded and brought either in federal court or in front of an SEC body appointed in a constitutionally valid manner.<sup>165</sup>

In order to fix the constitutional flaw in the appointment process for its ALJs, the SEC could implement a relatively easy solution: reappoint the ALJs in a constitutionally valid manner.<sup>166</sup> This process would involve a vote by the Commissioners to reappoint the ALJs, thus satisfying the Appointments Clause requirement that inferior officers be appointed by the President, Courts of Law, or Heads of Departments.<sup>167</sup> However, if the SEC chooses to enact this reappointment process prior to any Court decision on the matter, it could be tacitly giving substance to current constitutional challenges to its ALJs.<sup>168</sup> Moreover, any alteration to the structure of SEC ALJs could sound the bell for constitutional challenges to ALJs across the federal government.<sup>169</sup>

Presently, the SEC has only taken minor steps to appease recent outcries over administrative law proceedings.<sup>170</sup> In September 2015, the SEC proposed amendments to its rules governing administrative proceedings.<sup>171</sup> Most importantly, these amendments would:

Adjust the timing of administrative proceedings, including [] extending the time before a hearing occurs in appropriate cases, [p]ermit parties to take depositions of witnesses as part of discovery, and [r]equire parties in administrative proceedings to submit filings and serve each other electronically, and to redact certain sensitive personal information from those filings.<sup>172</sup>

While these amendments serve to address the due process claims

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164. *Id.*

165. Hardy et al., *supra* note 22, at 5.

166. *Id.*

167. See U.S. CONST. art II, § 2, cl. 2 (vesting power of appointment of inferior officers to the President, Courts of Law, or the Heads of Departments).

168. Hardy et al., *supra* note 22, at 6.

169. *Id.*

170. See Press Release, Sec. and Exch. Comm'n, SEC Proposes to Amend Rules Governing Administrative Proceedings (Sept. 24, 2015), <http://www.sec.gov/news/pressrelease/2015-209.html> (proposing to amend the procedure of SEC administrative law proceedings by increasing procedural safeguards).

171. *Id.*

172. *Id.*

raised by defendants, they completely fail to address to the glaring constitutional flaw in the SEC ALJs appointment process.<sup>173</sup>

In response to the SEC's inaction, Representative Scott Garrett of the House Financial Services Committee recently introduced a bill to rectify many of the procedural defects in the SEC's administrative law proceedings.<sup>174</sup> If passed, the Due Process Restoration Act of 2015 would "permit private persons to compel the Securities and Exchange Commission to seek legal or equitable remedies in a civil action, instead of in an administrative proceeding."<sup>175</sup> In essence, parties to SEC administrative law proceedings would be able to force the SEC to bring an action in federal court, instead of in front of agency ALJs.<sup>176</sup> This option to compel would ensure that parties to these actions enjoy constitutional protection of their procedural rights, while simultaneously allowing the SEC to continue to pursue expansive monetary penalties.<sup>177</sup> In the short term, absent any change to its appointment process through SEC or congressional action, the SEC should return to its historical venue for enforcing security regulations—federal court. Not only will the formalities of federal court lead to more satisfied defendants, but the SEC will also maintain high success rates in proceedings and simultaneously gain public good will.

GILES D. BEAL IV

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173. *See id.* (making no mention of the disputed constitutionality of the appointment process).

174. *See* Due Process Restoration Act of 2015, H.R. 3798, 114th Cong. (Sept. 22, 2015).

175. *Id.*

176. *Id.*

177. Mike Sacks, *SEC In-House Is Target of House Bill*, NATL. L.J. (Nov. 2, 2015), <http://www.nationallawjournal.com/id=1202741222050/SEC-InHouse-Venue-is-Target-of-House-Bill?mcode=0&curindex=0&curpage=2> (describing the recently proposed House bill to amend the SEC's administrative law proceedings).