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ALJs Check Their Own Work, With Unsurprising Results

By **Marc Fagel** (March 2, 2018, 11:33 AM EST)

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Legal challenges to the manner in which the U.S. Securities and Exchange Commission appoints its in-house administrative law judges have been something of a cottage industry in recent years. These challenges will come to a head in April, when the Supreme Court is expected to hear arguments in Lucia v. SEC, a case raising the issue of whether the SEC's ALJs are officers of the United States within the meaning of the Constitution's appointments clause.[1]

Meanwhile, during the course of the briefing in Lucia, the federal government reversed course on the constitutional question. Although the U.S. Department of Justice had previously defended the SEC on the ground that its ALJs were "mere employees" not subject to the appointments clause, the U.S. solicitor general issued a mea culpa and conceded that ALJs are in fact officers, and thus were not properly appointed by the SEC.[2] On Nov. 30, 2017, in response to the DOJ's move, the SEC issued an order providing that the commission "hereby ratifies the agency's prior appointment" of its five current ALJs, purportedly to "put to rest any claim that administrative proceedings pending before, or presided over by" its ALJs violate the appointments clause.[3]

The SEC's Nov. 30 order also required the sitting ALJs to "reconsider the record" in all open actions, allow the parties to submit new evidence, and, by Feb. 16, issue an order determining whether the ALJ would "ratify or revise in any respect" his or her prior actions. In other words, the judges whose original appointments admittedly violated the U.S. Constitution were asked to determine whether, having now been "ratified" by the SEC commissioners, they have had a change of heart.

Readers will presumably be unsurprised to learn that, no, they did not.

You Say You Want a Ratification

The SEC's Nov. 30 order appended a list of just over 100 administrative proceedings in which an ALJ had issued an initial decision and was being directed to reopen the record and reconsider his or her prior rulings. While this might seem like a somewhat daunting task, the actual workload imposed on the ALJs was much lighter than it appears.

First, over two-thirds of the identified cases were uncontested. Most of these were routine proceedings under Section 12(j) of the Exchange Act to deregister the securities of public companies with delinquent

SEC filings, where no company representative had appeared and the ALJ had ordered deregistration by default. In these cases, the SEC's Division of Enforcement made boilerplate submissions urging ratification, and the ALJs quickly dispatched of the matters. As Chief Administrative Law Judge Brenda Murray succinctly stated in the typical order, "I have reconsidered the record, including all my substantive and procedural orders, and I RATIFY all the actions that I took in this proceeding before November 30, 2017."[4]

Second, even in the minority of cases where at least one party litigated against the Division of Enforcement, most of the respondents — who were notified of the SEC's Nov. 30 order and invited to submit new evidence — declined to seek further review. In these matters as well, the ALJs issued orders stating that they had reviewed the record and determined to ratify their prior actions.[5]

Which leaves the small number of proceedings in which a party actually made some effort to capitalize on the SEC's ratification order. In a handful of cases, respondents submitted additional briefing, and in each case (with one minor caveat) the ALJ declined to revise his or her rulings. Almost invariably, respondents advanced legal arguments rather than offering new evidence, with such arguments roundly rejected by the ALJs. As one ALJ curtly noted, respondent "renews a number of points regarding the merits of the initial decision that she previously raised in her post-hearing briefs … I have considered all these points, … and they are as unpersuasive now as they were originally."[6]

However, several respondents did offer new arguments — typically meeting with little success but at least warranting a little more attention from the ALJs. For example, several parties challenged the SEC's ratification of the ALJ's appointment as failing to cure the constitutional defect of the ALJ's original selection. One ALJ, rejecting several such challenges, invoked arguably circular reasoning and simply cited to the SEC's ratification order, holding that his appointment "has been ratified by the Commission, 'thereby resolving any Appointments Clause claims' in this proceeding."[7]

Several respondents also argued that the SEC's ALJ appointments suffered from another appointments clause infirmity regarding limitations on the ALJs' removal, citing the Supreme Court's decision in Free Enterprise Fund v. Public Company Accounting Oversight Board.[8] The ALJs similarly rejected this argument, citing an SEC opinion (currently pending appeal to the D.C. Circuit), which declined to follow Free Enterprise.[9] One ALJ further contended that such challenges under the appointments clause are ultimately irrelevant because the SEC reviews the ALJs' decisions de novo, and thus the respondent will have "all the possibility for relief" that he or she would have received from a properly appointed ALJ.[10]

Similar arguments considered (but rejected) by the ALJs include: (1) the original order instituting administrative proceedings was legally invalid because it included the assignment of the matter to an improperly appointed ALJ; and (2) after-the-fact ratification of an ALJ order is inadequate, and a new hearing is required.

Some respondents offered arguments beyond the infirmity of the ALJ appointments. For example, one respondent argued that an intervening regulatory change since the initial decision warranted mitigating the sanction that the ALJ had entered against him. However, the ALJ concluded that the regulatory change did not impact the respondent's liability, and thus determined to ratify his decision.[11]

In another matter involving the deregistration of the securities of a delinquent issuer, a "major shareholder" of the company asked the ALJ to stay proceedings to allow time for another entity to purchase the company and bring its filings current. The ALJ treated the request as a submission of new evidence under the Nov. 30 order, but ultimately determined that it was "simply too late" for the company to bring itself current and ratified his initial deregistration decision.[12]

And in a particularly colorful matter, a respondent submitted "over 80 single-spaced pages," including a letter to the president, in which he blamed the past rulings against him on medical issues, judicial bias, and "a plot to violate his rights" by the chief ALJ. Needless to say, the presiding ALJ — in a sprawling 32-page order — rejected the challenge, observing the respondent's "history of concocting false medical excuses" and "his penchant for inventing facts."[13]

Of the 100-plus cases identified in the SEC's ratification order, it appears that an ALJ was willing to adjust a prior ruling in just one of them. In that matter, the ALJ rejected the contention that he was biased against the respondent, asserting that "I was impartial and disinterested when I presided over this proceeding originally, I continue to be impartial and disinterested, and if I were not, I would recuse myself."[14] However, a second argument met with greater success. The respondent argued that while he had been charged with violating only a specific subsection of Section 206 of the Investment Advisers Act, the initial decision improperly ordered him to cease and desist from violating the entire section. The ALJ agreed to narrow his order so as to be limited to future violations of the same subsection.

The SEC's Nov. 30 order did generate a few other responses of note. In one case, it was the Division of Enforcement that seized on the reopening of the record, contesting the ALJ's initial finding that the respondent had demonstrated an inability to pay disgorgement and penalties. The division submitted evidence purporting to show that the respondent had in fact made an all-cash home purchase shortly before the initial decision was issued, and asked the ALJ to withdraw his determination that the respondent had an inability to pay and instead impose full disgorgement as well as a monetary penalty.[15] The ALJ in that matter is currently considering the additional evidence and the respondent's response.

And in one case involving an accused Ponzi scheme operator serving time in federal prison, the respondent reacted to the Nov. 30 order by sending a handwritten note to the ALJ proclaiming that he was the messiah and that the United States would be destroyed if he was not released from prison within three days.[16] The ALJ (apparently waiting more than three days after the letter was received by the SEC) noted that he did not have the authority to grant a writ of habeas corpus.[17] The ALJ subsequently ratified his initial decision.

Conclusion

While the deadline has been extended for a few remaining ratification determinations, it is fair to say that the SEC's directive that ALJs reconsider the record in pending proceedings has not resulted in a groundswell of revised rulings. The ALJs, whose "previous appointments" have now been "ratified" (in the words of the SEC), are not suddenly seeing these cases through a brand new lens. While the ALJs' determination to leave nearly all of their prior rulings untouched is unsurprising, it remains to be seen whether a higher authority revisits some of the conclusory rulings issued by the judges.

For example: Is it truly sufficient for an ALJ who was not properly appointed to have his or her selection "ratified" by the SEC? Even if so, can such an ALJ "ratify" the actions he or she took previously simply by reviewing the existing record rather than conducting a new trial?

Moreover, some larger questions will remain to be addressed regardless of the Supreme Court's ruling in Lucia. Most significantly, can ALJs of a federal agency, regardless of how they are appointed, be expected to issue truly objective rulings in proceedings in which the agency is a party? This question, and others regarding the overall fairness of administrative adjudications, are likely to feature in the next round of battles to face the courts.

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DISCLOSURE: Gibson, Dunn is counsel of record in Lucia v. SEC, which is discussed here.

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[1] For those not closely following the issue, some brief background: The appointments clause requires that "inferior officers" of the United States must be appointed by the president, a court, or the head of a department. At the SEC, the commissioners themselves do not appoint the ALJs; rather, they are hired by SEC staff from a pool of candidates identified by the federal Office of Personnel Management. The SEC has defended this practice by arguing that ALJs are mere employees of the agency, not officers.

[2] Lucia v. SEC, No. 17-130, Brief for the Respondent (Nov. 29, 2017), available at www.supremecourt.gov/DocketPDF/17/17-130/21998/20171129155714442_17-130%20Lucia.pdf.

[3] In re Pending Administrative Proceedings, Securities Act of 1933 Release No. 10440 (Nov. 30, 2017), available at www.sec.gov/litigation/opinions/2017/33-10440.pdf.

[4] See, e.g., In re David Lubin., Admin. Proc. File No. 3-18070 (Feb. 7, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5577.pdf (caps in original).

[5] See, e.g., In re John Briner et al., Admin. Proc. File No. 3-16339 (Jan. 26, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5538.pdf.

[6] In re David S. Hall, P.C. et al., Admin. Proc. File No. 3-17228 (Jan. 26, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5544.pdf. See also In re David Pruitt, Admin. Proc. File No. 3-17950 (Feb. 14, 2018) (reconsidering and rejecting legal arguments raised in a prior motion for a ruling on the pleadings), available at www.sec.gov/alj/aljorders/2018/ap-5599.pdf.

[7] Id.; see also In re Laurie Bebo et al., Admin. Proc. File No. 3-16293 (Feb. 16, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5615.pdf.

[8] 561 U.S. 477 (2010) (invalidating ALJ appointments by Public Company Accounting Oversight Board).

[9] See In re David S. Hall PC, citing In re Timbervest LLC, Admin. Proc. File No. 3-15519 (Sept. 15, 2015), available at www.sec.gov/litigation/opinions/2015/ia-4197.pdf.

[10] See In re Bebo.

[11] In re Joseph J. Fox, Admin. Proc. File No. 3-16795 (Feb. 2, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5564.pdf.

[12] In re Guardian 8 Holdings et al., Admin. Proc. File No. 3-18221 (Feb. 14, 2018), available

at www.sec.gov/alj/aljorders/2018/ap-5590.pdf.

[13] In re Edward M. Daspin et al., Admin. Proc. File No. 3-16509 (Feb. 20, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5619.pdf.

[14] In re Paul Edward "Ed" Lloyd Jr., Admin. Proc. File No. 3-16182 (Jan. 26, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5539.pdf.

[15] See In re Alexander Clug et al., Admin. Proc. File No. 3-16318 (Jan. 12, 2018), available at www.sec.gov/alj/aljorders/2018/ap-5456.pdf.

[16] In re Shervin Neman et al., Admin. Proc. File No. 3-17699 (Dec. 27, 2017), available at www.sec.gov/litigation/apdocuments/3-17699-event-38.pdf.

[17] In re Shervin Neman et al., Admin. Proc. File No. 3-17699 (Dec. 28, 2017), available at www.sec.gov/alj/aljorders/2017/ap-5426.pdf.