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## Creating Mischief: The Tenth Circuit Declares the SEC's Administrative Law Judges Unconstitutional in *Bandimere V. Securities Exchange Commission*

Casey M. Olesen

*University of Maine School of Law*, [casey.olesen@maine.edu](mailto:casey.olesen@maine.edu)

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CREATING MISCHIEF: THE TENTH CIRCUIT  
DECLARES THE SEC'S ADMINISTRATIVE LAW  
JUDGES UNCONSTITUTIONAL IN *BANDIMERE V.  
SECURITIES EXCHANGE COMMISSION*

*Casey M. Olesen*

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## CREATING MISCHIEF: THE TENTH CIRCUIT DECLARES THE SEC'S ADMINISTRATIVE LAW JUDGES UNCONSTITUTIONAL IN *BANDIMERE V. SECURITIES EXCHANGE COMMISSION*

Casey M. Olesen\*

### ABSTRACT

Since the passage of the APA, administrative agencies' use of Administrative Law Judges (ALJs) to preside over hearings has exploded, and now far outpaces the number trials conducted before federal judges. The Securities and Exchange Commission (SEC) is one such agency that heavily utilizes ALJs to conduct their hearings. Recently, following an apparent higher percentage of SEC wins before their own ALJs as compared to before federal judges, a new constitutional challenge on the basis of the Appointments Clause has been brought before several circuits; that the SEC's ALJs are inferior officers of the SEC, not employees, and therefore are required to be appointed pursuant to the requirements of the Appointments Clause. The support for this challenge comes from the Supreme Court's decision in *Freytag v. Commissioner*, which laid out three indicia of inferior officer status. In 2016, both the D.C. Circuit and the Tenth Circuit had occasion to decide this issue, with the former ruling in favor of the SEC's ALJs, and the latter against. The circuit split has left the status of the SEC's ALJs in a state of flux, with more challenges certain to come, including challenges to other agencies' ALJs. This Note argues that the Tenth Circuit's decision in *Bandimere v. SEC* more faithfully applied the Supreme Court's indicia of officer status, and properly declared the SEC's ALJs inferior officers.

### I. INTRODUCTION

*"Today the Federal Government has a corps of administrative law judges numbering more than 1,000 whose principle statutory function is the conduct of adjudication under the Administrative Procedures Act. They are all executive officers."*<sup>1</sup>

The modern Administrative Law Judge ("ALJ") position was created by Congress in the Administrative Procedure Act of 1946 ("APA"), replacing the position previously known as "hearing examiners."<sup>2</sup> Prior to the APA, concerns often arose that hearing examiners could not truly exercise independent judgment

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\* J.D. Candidate, University of Maine School of Law, Class of 2018. The Author would like to thank Professor Jeff Thaler for his many edits and comments over multiple drafts and for providing guidance in the writing of this Note. The Author is also grateful to his editor, Ashley Perry, as well as his family for their continued support.

<sup>1</sup> *Freytag v. Comm'r*, 501 U.S. 868, 910 (1991) (Scalia, J., concurring).

<sup>2</sup> *Classification & Qualifications*, OFFICE PERS. MGMT., <https://www.opm.gov/policy-data-oversight/classification-qualifications/general-schedule-qualification-standards/specialty-areas/administrative-law-judge-positions/> [<https://perma.cc/B32Y-C5RX>]; see also *Ramspeck v. Fed. Trial Exam'rs Conference*, 345 U.S. 128, 130 (1953).

because they were subordinate to executive officers within the agency they served, and performed both prosecutorial and investigative work in addition to their judicial role.<sup>3</sup> The APA attempted to remedy these concerns by adding protections guaranteeing the independence of ALJs.<sup>4</sup>

Since the passage of the APA, the use of ALJs and administrative hearings has exploded and now far outpaces the number of traditional trials within the United States.<sup>5</sup> In fact, federal judges will decide roughly 95,000 adjudicatory proceedings in a year, including trials.<sup>6</sup> But that number pales in comparison to the more than 939,000 adjudicatory proceedings that are completed by federal administrative agencies in that same period.<sup>7</sup> Under this system, the modern ALJ has powers that the Supreme Court has described as “functionally comparable” to those of an Article III judge.<sup>8</sup> Commensurate with this power, ALJs have been granted immunity for actions taken in their judicial roles.<sup>9</sup>

As of 2016, the Federal Government employs over 1,770 ALJs.<sup>10</sup> A sampling of agencies employing ALJs include the National Labor Relations Board (thirty-four ALJs), the United States Postal Service (one ALJ), the Department of Labor (forty-one ALJs), and the Department of Health and Human Service’s Office of Medicare Hearings and Appeals (eighty ALJs).<sup>11</sup> But of all agencies, the Social Security Administration employs by far the most at over 1,500.<sup>12</sup> At interest here, however, are the ALJs utilized by the Securities and Exchange Commission, which presently employs five ALJs.<sup>13</sup>

In 2010, the authority granted to the SEC’s ALJs was expanded by the Dodd-Frank Act, expanding the civil penalties available to ALJs, and extending their jurisdiction.<sup>14</sup> Since the expansion, there has been a jump in the SEC’s use of administrative hearings rather than federal trials to adjudicate enforcement actions.<sup>15</sup>

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<sup>3</sup> *Butz v. Economou*, 438 U.S. 478, 513-14 (1978).

<sup>4</sup> *Id.* at 514.

<sup>5</sup> Jonathon Turley, *The Rise of the Fourth Branch of Government*, THE WASH. POST (May 24, 2013), [https://www.washingtonpost.com/opinions/the-rise-of-the-fourth-branch-of-government/2013/05/24/c7faaad0-c2ed-11e2-9fe2-6ee52d0eb7c1\\_story.html](https://www.washingtonpost.com/opinions/the-rise-of-the-fourth-branch-of-government/2013/05/24/c7faaad0-c2ed-11e2-9fe2-6ee52d0eb7c1_story.html) [<https://perma.cc/TDE9-7GW7>]; see also W. Michael Gillette, *Administrative Law Judges, Judicial Independence, and Judicial Review: Qui Custodiet Ipsos Custodes?*, 20 J. NAT’L ASS’N ADMIN. L. JUDGES 95, 100 (2000) (noting that the Social Security Administration’s ALJs decided more cases in one year than all traditional court systems in the United States combined).

<sup>6</sup> Turley, *supra* note 5.

<sup>7</sup> *Id.*

<sup>8</sup> *Butz*, 438 U.S. at 513.

<sup>9</sup> *Id.* at 514.

<sup>10</sup> Office of Personnel Management, *Administrative Law Judges*, <https://www.opm.gov/services-for-agencies/administrative-law-judges/#url=ALJs-by-Agency> [<https://perma.cc/DQ5M-RJVV>] (number of ALJs current as of December 2016).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> See 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012) (penalties available); 15 U.S.C. §§ 78o, 78o-4, 78q-1, 78u-3, 80b-3 (2012) (jurisdiction).

<sup>15</sup> Breon Peace et al., *The Future of SEC Administrative Proceedings*, LAW360 (Jan. 4, 2017, 11:20 AM), <https://www.law360.com/articles/876875/the-future-of-sec-administrative-proceedings> [<https://perma.cc/3F2P-4JTA>].

Exemplifying this jump, the SEC brought only thirty-five percent of its enforcement actions as administrative hearings between 2010 and 2013, but in 2015 brought seventy-six percent.<sup>16</sup> This is less surprising when noting that the SEC prevailed in sixty-one percent of cases brought in federal court, but one hundred percent of in-house administrative hearings before its ALJs in 2014.<sup>17</sup> Even further, it has been suggested by commentators that administrative proceeding procedural rules disadvantage those against whom enforcement actions are brought.<sup>18</sup>

This variation in outcome between the two forums has been brought to the public's eye by large media outlets, compounding the view that administrative proceedings are inherently unfair to defendants.<sup>19</sup> But it is important to note that critics have found at least one such study to be empirically unfounded.<sup>20</sup> In a recent review, a commentator noted that "there is no robust correlation between the selected forum and case outcome."<sup>21</sup> However, this conclusion was caged by a statement that the "finding does not imply that the type of forum in which the SEC litigates does not matter. Rather, there are significant empirical obstacles to finding any useful results by comparing case outcomes."<sup>22</sup>

The apparent disparity, whether empirically founded or not, between the SEC's win rates in federal trials versus in-house administrative proceedings lends itself to challenge in court.<sup>23</sup> While many of these challenges focus on due process, equal protection, or the right to a trial,<sup>24</sup> a new constitutional challenge has begun to emerge—that the SEC's ALJs hold their positions in contravention to the Constitution.<sup>25</sup> That challenge is based on the Appointments Clause, which requires that officers of the United States be appointed in a specific manner.<sup>26</sup> The Seventh Circuit was the first federal appellate court to have this issue before it, but dismissed the case for lack of subject matter jurisdiction.<sup>27</sup> However, in 2016, two separate Circuit Courts reached the merits of the Appointments Clause challenge to SEC

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<sup>16</sup> *Id.*

<sup>17</sup> Carmen Germaine, *Circuits Split Widely On SEC Judges' Constitutionality*, LAW360 (Jan. 3, 2017, 10:31 PM), <https://www.law360.com/articles/876758/circuits-split-widely-on-sec-judges-constitutionality> [<https://perma.cc/YMD2-2MKD>].

<sup>18</sup> See William McLucas & Matthew Martens, *How to Rein in the SEC*, WALL ST. J. (June 3, 2015), <https://www.wsj.com/articles/how-to-rein-in-the-sec-1433285747> [<https://perma.cc/X2RZ-FCPX>].

<sup>19</sup> See e.g., Jean Eaglesham, *SEC is Steering More Trials to Judges It Appoints*, WALL ST. J. (Oct. 21, 2014), <http://www.wsj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590> [<https://perma.cc/F9U9-XYZY>]; Gretchen Morgenson, *At the SEC, 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> [<https://perma.cc/L8EK-QLF3>].

<sup>20</sup> See, e.g., Urska Velikonja, *Are the SEC's Administrative Law Judges Biased? An Empirical Investigation*, 92 WASH. L. REV. 315, 315 (2017) (asserting that "the evidence offered by the Wall Street Journal is deficient and its conclusions unfounded").

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> See David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L.R. 1155, 1157-59, 1158 n.10 (2016) (citing cases where the constitutionality of SEC administrative proceedings has been challenged).

<sup>24</sup> *Id.*

<sup>25</sup> See, e.g., *Tilton v. SEC*, 824 F.3d 276, 281 (2d Cir. 2016); *Bebo v. SEC*, 799 F.3d 765, 768 (7th Cir. 2015).

<sup>26</sup> U.S. CONST. art. II, § 2, cl. 2.

<sup>27</sup> *Bebo*, 799 F.3d at 768.

ALJs, with a third dismissing the claim on jurisdictional grounds.<sup>28</sup> In the circuits that reached the merits, the losing parties filed for rehearing *en banc*—both were denied.<sup>29</sup>

This Note considers the question of whether or not SEC ALJs are inferior officers subject to the Appointments Clause, arguing for an affirmative answer to that question through an interpretation of the most applicable Supreme Court precedent, *Freytag v. Commissioner*. This question is presented through the lens of the Tenth Circuit's recent decision in *Bandimere v. SEC*, where a divided panel decided that the SEC's ALJs were inferior officers requiring constitutional appointment.<sup>30</sup> An opposing view is offered in *Raymond J. Lucia Cos. v. SEC*, where the D.C. Circuit held to the contrary.<sup>31</sup>

First, a brief overview of the factual and procedural background of *Bandimere* is presented. Next, the applicable legal framework is provided, including a general overview of the ALJ position, the Appointments Clause, and the Supreme Court's precedent in *Freytag*. The opposing views of the D.C. Circuit and the Tenth Circuit are then presented, followed by an analysis of why the Tenth Circuit's interpretation of *Freytag* properly applies the Supreme Court's precedent on the Appointments Clause, and better balances other considerations relevant to the discussion of the role of ALJs.

## II. FACTUAL AND PROCEDURAL BACKGROUND

On December 6, 2012, the SEC issued an Order Instituting Administrative Proceedings against David F. Bandimere, alleging multiple violations of various antifraud and registration provisions established by multiple securities statutes and SEC rules.<sup>32</sup> The allegations included operating as an unregistered broker and selling unregistered investments in Ponzi schemes, misleading investors by solely providing positive outlooks on investments, and failing to disclose any red flags or potentially negative facts about investments.<sup>33</sup> Bandimere admitted that the companies were Ponzi schemes, but denied any further allegations, claiming that he was also a victim of the Ponzi schemes with an investment of \$1.2 million dollars of his own money into the same companies.<sup>34</sup>

An administrative hearing was held from April 22 to April 26, 2013, and on May 2, 2013.<sup>35</sup> The hearing was presided over by one of the SEC's ALJs.<sup>36</sup> On October

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<sup>28</sup> See *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 283 (D.C. Cir. 2016) (holding SEC ALJs to be employees), *petition for cert. filed*, No. 17-130 (U.S. July 26, 2017); *Bandimere v. SEC*, 844 F.3d 1168, 1181 (10th Cir. 2016) (holding SEC ALJs to be inferior officers requiring appointment), *petition for cert. filed*, No. 17-475 (U.S. Sept. 29, 2017); *Tilton*, 824 F.3d at 281 (dismissing for lack of subject matter jurisdiction).

<sup>29</sup> *Bandimere v. SEC*, 855 F.3d 1128, 1128 (10th Cir. 2017) (denying rehearing *en banc*); *Raymond J. Lucia Cos. v. SEC*, No. 15-1345, 2017 WL 2727019, at \*1 (D.C. Cir. Feb. 16, 2017) (per curiam) (denying rehearing *en banc*).

<sup>30</sup> 844 F.3d at 1181.

<sup>31</sup> 832 F.3d at 289.

<sup>32</sup> David F. Bandimere, SEC Release No. 507, 2013 WL 5553898, \*1 (Oct. 8, 2013).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at \*2.

<sup>35</sup> *Id.* at \*1.

<sup>36</sup> *Id.*

8, 2013, the ALJ issued an initial decision, concluding that Bandimere committed the myriad of violations alleged against him.<sup>37</sup> The ALJ imposed civil penalties of \$390,000, ordered disgorgement of \$638,056.33 plus prejudgment interest, and barred Bandimere from the securities industry.<sup>38</sup>

Bandimere appealed this decision, seeking review of the ALJ's decision by the Commission.<sup>39</sup> Bandimere advanced multiple arguments to the Commission, including an arbitrary and capricious denial of an evidence production request against the SEC, an Equal Protection Clause claim, and most importantly, an Appointments Clause claim.<sup>40</sup> The SEC upheld the ALJ's denial of Bandimere's request for evidence production and rejected his Equal Protection claim.<sup>41</sup> These issues were not reached upon appeal.<sup>42</sup> As for the Appointment's Clause challenge, the SEC Commission conceded that the ALJ had not been properly appointed, but ultimately rejected the challenge.<sup>43</sup> The SEC defended this result by viewing its ALJs not as officers requiring appointment, but as mere employees.<sup>44</sup>

The SEC Commission ultimately found Bandimere liable, issuing a separate final opinion instituting the same penalties imposed by the ALJ.<sup>45</sup> Following the SEC Commission's final order, Bandimere appealed to the Tenth Circuit, once again raising an Appointments Clause challenge.<sup>46</sup>

### III. ADMINISTRATIVE LAW JUDGES

The administrative law judge position "is not a creature of administrative law; rather it is a direct creation of Congress . . ."<sup>47</sup> The position's duties and functions are set forth within the APA, which allows for ALJs to preside over the taking of evidence at an administrative hearing.<sup>48</sup> An administrative agency may "appoint as many administrative law judges as are necessary for proceedings" conducted pursuant to the APA.<sup>49</sup>

All ALJs are hired through a merit-selection process administered by the Office of Personnel Management ("OPM").<sup>50</sup> Aspiring ALJs must be licensed, active status attorneys or have judicial status, and are ranked according to an exam administered by the OPM.<sup>51</sup> The SEC then hires from the top three ranked candidates.<sup>52</sup> Once hired, an ALJ holds their position for the entirety of their career, and can only be fired by the United States Merit Systems Protection Board ("MSPB") for good

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<sup>37</sup> *Id.*

<sup>38</sup> *Id.* at \*85-86.

<sup>39</sup> David F. Bandimere, SEC Release No. 9972, 2015 WL 6575665, \*1 (Oct. 29, 2015).

<sup>40</sup> *Id.* at \*17-23.

<sup>41</sup> *Id.* at \*17, \*22-23.

<sup>42</sup> See *Bandimere v. SEC.*, 844 F.3d 1168, 1176 (10th Cir. 2016).

<sup>43</sup> David F. Bandimere, SEC Release No. 9972, 2015 WL 6575665, \*19-21 (Oct. 29, 2015).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at \*32.

<sup>46</sup> *Bandimere*, 844 F.3d at 1171.

<sup>47</sup> *Mullen v. Bowen*, 800 F.2d 535, 540 n.5 (6th Cir. 1986).

<sup>48</sup> 5 U.S.C. § 556(b) (2012).

<sup>49</sup> *Id.* § 3105.

<sup>50</sup> *Id.* § 1302; 5 C.F.R. § 930.201 (2007).

<sup>51</sup> 5 C.F.R. §§ 930.204, 337.101.

<sup>52</sup> *Bandimere v. SEC.*, 844 F.3d 1168, 1176-77 (10th Cir. 2016).

cause.<sup>53</sup>

Agencies are able to delegate certain authority to its ALJs. For the SEC, statutory authority provides that “any of its functions” may be delegated to its ALJs with the exception of rulemaking.<sup>54</sup> Utilizing that authority, the SEC has delegated the ability to “conduct hearings” and the “responsib[ility] for the fair and orderly conduct of the proceedings” to its ALJs, including the “authority to do all things necessary and appropriate to discharge [their] duties.”<sup>55</sup> This includes the administration of oaths and affirmations; the determination of “scope and form of evidence”; the entering of default judgment; examination of witnesses; issuance of protective orders; issuance, modification, and revocation of subpoenas; ruling on all motions; ruling on evidentiary issues; and the preparation of initial factual findings, legal conclusions, and appropriate order.<sup>56</sup>

#### IV. THE APPOINTMENTS CLAUSE

The Appointments Clause has been described by the Supreme Court as having been drafted with more than “etiquette or protocol [] describing ‘Officers of the United States,’” and the appointment process in mind.<sup>57</sup> Instead, it “is among the significant structural safeguards of the constitutional scheme.”<sup>58</sup> In its entirety, 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>59</sup>

This clause encompasses both structural and political principles. First, it serves as a safeguard “against one branch’s aggrandizing its power at the expense of another branch,”<sup>60</sup> while “preventing the diffusion of the appointment power.”<sup>61</sup> Such protections “embod[y] both separation of powers and checks and balances.”<sup>62</sup> Second, the Appointments Clause is “designed to ensure public accountability for both the making of a bad appointment and the rejection of a good one.”<sup>63</sup> Thus, those

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<sup>53</sup> 5 U.S.C. § 7521(a), (b) (setting forth actions the MSPB can take against ALJs); 5 C.F.R. § 930.204 (“An administrative law judge receives a career appointment . . .”). The Merit Systems Protection Board consists of three members appointed by the President, and removable only for good cause. 5 C.F.R. § 1200.2 (1991).

<sup>54</sup> 15 U.S.C. § 78d-1(a) (2012).

<sup>55</sup> 17 C.F.R. §§ 200.14, 201.111 (2017).

<sup>56</sup> *Bandimere*, 844 F.3d at 1178 (listing duties and corresponding statutes and regulations).

<sup>57</sup> *Buckley v. Valeo*, 424 U.S. 1, 125 (1976) (per curiam).

<sup>58</sup> *Edmond v. United States*, 520 U.S. 651, 660 (1997).

<sup>59</sup> U.S. CONST. art. II, § 2, cl. 2.

<sup>60</sup> *Freytag v. Comm’r.*, 501 U.S. 868, 878 (1991).

<sup>61</sup> *Id.*

<sup>62</sup> *Bandimere v. SEC.*, 844 F.3d 1168, 1172 (10th Cir. 2016).

<sup>63</sup> *Edmond*, 520 U.S. at 660 (quoting Hamilton as observing that “[t]he blame of a bad nomination would fall upon the president singly and absolutely,” while “[t]he censure of a good [nomination] would lie entirely at the door of the senate . . .”).

wielding constitutional appointment power are “accountable to political force and the will of the people.”<sup>64</sup>

Beyond those lofty principles, the Appointments Clause does, in fact, also describe the procedures required to be used in appointing two classes of officers, principal officers (“officers”) and inferior officers. To satisfy the Appointments Clause, an officer of the United States must be nominated by the President, and confirmed by the Senate.<sup>65</sup> This method of appointment is also considered the “default manner of appointment for inferior officers.”<sup>66</sup> However, the Appointments Clause has an “Excepting Clause” allowing for Congress to confer the ability to appoint inferior officers to “the President alone, the Courts of Law, or the Heads of Departments.”<sup>67</sup> This “very clearly divides . . . officers into two classes.”<sup>68</sup>

This distinction between classes of officers arose due to the foresight of the Framers, who realized that “when offices become numerous, and sudden removals necessary,” requiring the action of both the President and the Senate “might be inconvenient.”<sup>69</sup> Therefore, the Constitution provides for Congress to delegate its constitutionally vested appointments power to the President, a court of law, or the head of a department.<sup>70</sup>

An officer of the United States has been simply described as “any appointee exercising significant authority pursuant to the laws of the United States,” or “all persons who can be said to hold an office under the government . . . .”<sup>71</sup> Inferior officers also exercise such authority, but are distinct from an officer in that “the term ‘inferior officer’ connotes a relationship with some higher ranking officer or officers below the President . . . .”<sup>72</sup> The Supreme Court has then helpfully stated that a determination of whether an officer is “inferior” rests on “whether he has a superior.”<sup>73</sup>

Beyond that extremely circular definition, the Supreme Court has described inferior officers in various other ways, including: those being charged with “the administration and enforcement of the public law,”<sup>74</sup> persons being granted “significant authority,”<sup>75</sup> those holding the “responsibility for conducting civil litigation in the courts of the United States,”<sup>76</sup> and those that hold an office created by regulations or statutes.<sup>77</sup>

Over a span of more than 150 years, the Court has declined to state a specific

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<sup>64</sup> *Freytag*, 501 U.S. at 884.

<sup>65</sup> See *Edmond*, 520 U.S. at 659-60; *United States v. Germaine*, 99 U.S. 508, 510 (1878).

<sup>66</sup> *Id.* at 660.

<sup>67</sup> *Id.*; U.S. CONST. art. II, § 2, cl. 2.

<sup>68</sup> *Germaine*, 99 U.S. at 510.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Buckley v. Valeo*, 424 U.S. 1, 126 (1976) (per curiam); *Germaine*, 99 U.S. at 510.

<sup>72</sup> *Edmond*, 520 U.S. at 662.

<sup>73</sup> *Id.*

<sup>74</sup> *Buckley*, 424 U.S. at 139.

<sup>75</sup> *Id.* at 126.

<sup>76</sup> *Id.* at 140.

<sup>77</sup> *United States v. Mouat*, 124 U.S. 303, 307-08 (1888); see also *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 539 (2010) (Breyer, J., dissenting) (summarizing the Supreme Court’s various definitions of inferior officers listed here).

and conclusive definition of inferior officer status.<sup>78</sup> Instead, the Court conducts a case-specific inquiry into the purported inferior officer.<sup>79</sup> Over the years, positions including district court clerks,<sup>80</sup> election monitors,<sup>81</sup> federal marshals,<sup>82</sup> military judges,<sup>83</sup> and judges in Article I courts have been declared inferior officers.<sup>84</sup>

Inferior officers are not the lowest class of civil servants within the Federal Government—below them are employees. An employee is considered “subordinate to officers of the United States,” as is an inferior officer.<sup>85</sup> For employees, the Appointments Clause does not apply.<sup>86</sup>

While the distinction between inferior officers and employees has not been widely litigated, the distinction is just as important as that between principal and inferior officers. It dictates how a civil servant may be hired or fired, who they answer to, and who stands accountable for their actions. When this difference is applied to ALJs, questions of impartiality, accountability, and fairness in the administrative system arise.

#### V. FREYTAG AND THE CIRCUIT SPLIT

The question whether the SEC’s ALJs are inferior officers or employees was first reached on the merits by a Circuit Court in August 2016, when the D.C. Circuit held that the SEC’s ALJs were employees, not inferior officers.<sup>87</sup> Four months later, the merits were reached again when the Tenth Circuit held the opposite.<sup>88</sup> A 1991 Supreme Court case, *Freytag v. Commissioner* provided the precedent for each circuit’s opinion.<sup>89</sup>

In *Freytag*, the Court confronted whether the Tax Court had the authority to appoint Special Tax Judges (STJs), who could be assigned to hear four statutory categories of cases.<sup>90</sup> For the first three of those categories, the STJs were able to hear, report, and decide the case on their own.<sup>91</sup> For the fourth category, the STJ could hear the case and prepare proposed findings and opinions, but could not actually decide the case.<sup>92</sup> Instead, a regular Tax Court judge—appointed by the President—needed to review the STJ’s proposed findings and opinion, and then

<sup>78</sup> See *Free Enter. Fund*, 561 U.S. at 539 (Breyer, J., dissenting) (“[E]fforts to define [inferior officer] inevitably conclude that the term’s sweep is unusually broad.”).

<sup>79</sup> See, e.g., *id.* at 539-40 (listing the various ways that the Supreme Court has defined “inferior officer”).

<sup>80</sup> *In re Hennen*, 38 U.S. 230, 258 (1839).

<sup>81</sup> *Ex parte Siebold*, 100 U.S. 371, 397-99 (1879).

<sup>82</sup> *Id.* at 397.

<sup>83</sup> *Weiss v. United States*, 510 U.S. 163, 170 (1994).

<sup>84</sup> *Freytag v. Comm’r*, 501 U.S. 868, 878 (1991); see also *Free Enter. Fund*, 561 U.S. at 540 (Breyer, J., dissenting) (listing those the Supreme Court has held to be inferior officers).

<sup>85</sup> *Buckley v. Valeo*, 424 U.S. 1, 126 n.162 (1976).

<sup>86</sup> See U.S. CONST. art. II, § 2, cl. 2 (only requiring appointment for officers and inferior officers).

<sup>87</sup> *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 283 (D.C. Cir. 2016).

<sup>88</sup> *Bandimere v. SEC*, 844 F.3d 1168, 1188 (10th Cir. 2016).

<sup>89</sup> 501 U.S. at 892. See *Bandimere*, 844 F.3d at 1173-76; *Lucia*, 832 F.3d at 284-86 (discussing *Freytag*, 501 U.S. 868).

<sup>90</sup> *Id.* at 873. The authority to appoint STJ to the cases was conferred under the then-applicable 26 U.S.C. § 7443A(B). *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

render a binding decision.<sup>93</sup> *Freytag*'s controversy arose under that fourth category.<sup>94</sup>

An STJ was assigned to the case, presided over the hearing, and issued a proposed opinion finding liability.<sup>95</sup> That opinion was subsequently adopted by the Tax Court.<sup>96</sup> On appeal, *Freytag* argued that the STJ was actually an inferior officer who had not been appointed in accordance with the requirements of the Appointments Clause.<sup>97</sup> Specifically, *Freytag* contended that the Chief Judge of the Tax Court lacked the ability to appoint inferior officers, as the Chief Judge was neither the President, a department head, nor a court of law.<sup>98</sup> The government sought to rebut that argument by claiming that STJs assigned under the fourth category of cases were not required to be appointed as they were employees of the Tax Court, not inferior officers.<sup>99</sup> In an odd attempt at supporting their argument, the government conceded that STJs assigned to cases under the first three categories were in fact inferior officers, but argued that STJs assigned to the fourth category of cases could not be inferior officers because they lacked authority to issue final decisions.<sup>100</sup>

Most of the *Freytag* decision was not spent on distinguishing between inferior officers and employees, but rather focused on whether the Chief Judge had the authority to appoint inferior officers.<sup>101</sup> Ultimately, the Supreme Court concluded that the Tax Court was in fact a court of law, and thus the Chief Judge wielded such authority.<sup>102</sup> However, in the Court's brief discussion of the distinguishing characteristics between employees and inferior officers, the Court set forth three indicia of inferior officer status: (1) the position was established by law; (2) the "duties, salary, and means of appointment for that [position were] specified by statute"; and (3) the position performed "more than ministerial tasks" in an "exercise [of] significant discretion."<sup>103</sup> Each of these indicia were answered in the affirmative as to the STJ position, leading to a conclusion that STJs were inferior officers.<sup>104</sup>

Moving on, the Court then stated that "[e]ven if the duties of [STJs] . . . were not as significant as [the Court] found them to be, [their] conclusion would be unchanged."<sup>105</sup> This contention seemed to be in response to the government's argument that *Freytag* had no standing to assert the duties of STJs assigned under the first three categories.<sup>106</sup> The Court dismissed this as "beside the point," as STJs could not be "inferior officers for purposes of some of their duties . . . but mere employees

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<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.* at 871-72.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 880.

<sup>98</sup> *Id.* at 882-83.

<sup>99</sup> *Id.* at 880-81.

<sup>100</sup> *Id.* at 882.

<sup>101</sup> *See generally id.* at 882-92.

<sup>102</sup> *Id.* at 890, 892. *But see id.* at 901 (Scalia, J., concurring) (agreeing that the STJ was an inferior officer, but finding the appointment valid with the Chief Judge as a department head, not a court of law).

<sup>103</sup> *Id.* at 881-82.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.* at 882.

<sup>106</sup> *Id.*

with respect to other responsibilities.”<sup>107</sup> “The fact that an inferior officer on occasion performs duties that may be performed by an employee . . . does not transform his status under the Constitution.”<sup>108</sup> As result, the Court held that STJs were inferior officers no matter what category of case was before them.<sup>109</sup>

## VI. THE D.C. CIRCUIT

The basic facts in the *Raymond J. Lucia Cos. v. SEC* are similar to those in *Bandimere*. As in *Bandimere*, the SEC charged multiple investment companies with misleading and deceptive advertising.<sup>110</sup> The SEC instituted administrative actions, and a hearing was held before an SEC ALJ.<sup>111</sup> The ALJ found liability, and the companies sought review by the SEC Commission who imposed the same sanctions.<sup>112</sup> The companies appealed to the D.C. Circuit, who agreed with the SEC on the Appointments Clause challenge.<sup>113</sup>

The D.C. Circuit’s ruling in *Lucia* can be traced back to its interpretation of *Freytag* in an earlier case, *Landry v. FDIC*.<sup>114</sup> There, the D.C. Circuit ruled that the Federal Deposit Insurance Corporation’s (“FDIC”) ALJs were not inferior officers because they exercised no final decision-making authority.<sup>115</sup> There, the D.C. Circuit ruled that the FDIC’s ALJs were not inferior officers because they exercised no final decision-making authority.<sup>116</sup> Instead, the ALJs made recommendations to the FDIC Board of Directors, who could choose whether or not to accept the recommendation.<sup>117</sup> Here, the D.C. Circuit first stated its view that the STJs’ authority to issue final decisions, at least in some cases, “was critical to the [Supreme] Court’s decision” in *Freytag*.<sup>118</sup>

In 2012, the D.C. Circuit reaffirmed this interpretation in *Tucker v. Commissioner*.<sup>119</sup> In *Tucker*, the D.C. Circuit was confronted with an Appointments Clause challenge to certain employees within the Internal Revenue Service’s Office of Appeals.<sup>120</sup> Relying on *Landry*, the D.C. Circuit stated that the “main criteria for drawing the line between inferior [o]fficers and employees not covered by the clause are (1) the significance of the matters resolved by the officials, (2) the discretion they exercise in reaching their decisions, and (3) the finality of those decisions.”<sup>121</sup>

Predictably, the D.C. Circuit continued to apply its interpretation of *Freytag* in 2016 when it decided *Lucia*. As in *Landry*, the D.C. Circuit again stated that:

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<sup>107</sup> *Id.*

<sup>108</sup> *Freytag v. Comm’r.*, 501 U.S. 868, 882 (1991).

<sup>109</sup> *See id.*

<sup>110</sup> *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 282-83 (D.C. Cir. 2016), *appeal denied*, 868 F.3d 1021 (D.C. Cir. June 26, 2017) (per curiam) (mem.).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 283.

<sup>113</sup> *See id.* at 285-86.

<sup>114</sup> 204 F.3d 1125, 1133 (D.C. Cir. 2000).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 1134.

<sup>119</sup> 676 F.3d 1129, 1133 (D.C. Cir. 2012).

<sup>120</sup> *Id.* at 1130-31.

<sup>121</sup> *Id.* at 1133.

[I]t understood that it “was critical to the [Supreme] Court’s decision” in *Freytag* that the [STJ] had authority to issue final decisions in at least some cases, because it would have been “unnecessary” for the Court to consider whether the tax judges had final decision-making power when the judge in *Freytag*’s case exercised no such power.<sup>122</sup>

With a lack of final decision-making power, the ALJ could not “be said to have been delegated sovereign authority or to have the power to bind third parties, or the government itself.”<sup>123</sup> Therefore, the exercise of final decision-making authority was determined to be the deciding factor in determining officer status.

In June 2017, a petition for rehearing of *Lucia en banc* was denied by an “equally divided” D.C. Circuit.<sup>124</sup>

## VII. THE TENTH CIRCUIT

The Tenth Circuit disagreed with the D.C. Circuit’s application of *Freytag*, with a concurring judge calling it a “truncated legal framework,”<sup>125</sup> but a dissenting opinion agreed with the D.C. Circuit’s approach.<sup>126</sup> The concurring judge wholeheartedly agreed with the majority, but wrote separately to repudiate the dissent’s arguments in greater detail.<sup>127</sup> Ultimately, the existence of three different opinions provide for a deep scrutiny of the Appointments Clause issue, as well as clear statements of arguments both for and against classifying the SEC’s ALJs as inferior officers.

In applying *Freytag*, the majority spent very little time, and the dissent and concurrence spent none, responding to the application of the first two characteristics of the Supreme Court’s inferior officer test. It was easily accepted that the SEC ALJ position was established by law—specifically the Administrative Procedures Act—and there was no argument that the duties, salary, and means of appointment were also provided by the APA in conjunction with SEC rules.<sup>128</sup> The final characteristic—the exercise of significant discretion—quickly became the centerpiece of the Tenth Circuit’s internal disagreement, as well as the delineating factor with the D.C. Circuit.<sup>129</sup>

### A. Significant Discretion and Final Decision-Making Authority

For the majority, the functions and duties of the ALJs were so closely “commensurate” with those of the STJs, that ALJs must be considered inferior

<sup>122</sup> Raymond J. Lucia Cos. v. SEC, 832 F.3d 277, 285 (D.C. Cir. 2016), cert. denied, 2017 WL 2727019 (D.C. Cir. June 26, 2017).

<sup>123</sup> *Id.*

<sup>124</sup> Raymond J. Lucia Cos. v. SEC, No. 15-1345, 2017 WL 2727019 at \*1 (D.C. Cir. June 26, 2017) (per curiam).

<sup>125</sup> Bandimere v. SEC., 844 F.3d 1168, 1188 (10th Cir. 2016) (Briscoe, J., concurring).

<sup>126</sup> *Id.* at 1194 (McKay, J., dissenting).

<sup>127</sup> *Id.* at 1188 (Briscoe, J., concurring) (“I write not to differ with the rationale of the majority, but rather to fully join it. My focus here is on the dissent.”).

<sup>128</sup> Compare *id.* at 1179 (only briefly discussing the first two characteristics), with *id.* at 1194-1201 (McKay, J., dissenting) (not disputing the first characteristic).

<sup>129</sup> See *id.* at 1179-80.

officers in the same vein.<sup>130</sup> Specifically, the majority pointed to the ALJs' "authority to shape the administrative record by taking testimony, regulating document production and depositions, ruling on the admissibility of evidence, ruling on dispositive and procedural motions, issuing subpoenas, and presiding over trial-like hearings" where credibility determinations were afforded "considerable weight" during SEC review.<sup>131</sup>

The most significant factor came in the form of the ALJs' ability to issue initial decisions that declare liability and impose sanctions.<sup>132</sup> If a party does not seek timely review by the SEC, "the action of [the ALJ] shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission."<sup>133</sup> But even if the party sought agency review, the SEC could decline the review in certain categories of cases, effectively rendering the ALJ decision final.<sup>134</sup> Further, the ALJ could enter default judgment against parties, hold and require attendance at settlement conferences, and "set aside, make permanent, limit, or suspend temporary sanctions that the SEC itself has imposed."<sup>135</sup> Each of these powers exemplify what the majority viewed as significant authority and discretion.

In response, both the SEC and the dissent argued that the SEC's ALJs could not possibly be inferior officers as they do not exercise final decision-making power.<sup>136</sup> The SEC and dissent supported this contention with the D.C. Circuit's reasoning in *Lucia*, in particular that the Supreme Court "laid exceptional stress on the STJs' final decision-making power," and with lack of such authority an ALJ could not be an inferior officer.<sup>137</sup> As the D.C. Circuit stated, the "analysis begins, and ends, there."<sup>138</sup>

The majority and concurrence disagreed with relying on the D.C. Circuit's precedent, believing it to be a "truncated framework" that "place[d] undue weight on final decision-making authority."<sup>139</sup> On the contrary, the majority believed that "properly read, *Freytag* did not place 'exceptional stress' on final decision-making power,"<sup>140</sup> as the STJs were classified as inferior officers based on the significance of their duties and authority.<sup>141</sup>

The majority supported this view by reading *Freytag*'s "even if" argument as a separate response to the standing challenge rather than "modify[ing] or supplant[ing] [the court's] holding that STJs were inferior officers based on the 'significance of

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<sup>130</sup> *Id.* at 1179.

<sup>131</sup> *Id.* at 1179-80.

<sup>132</sup> *Id.* at 1180.

<sup>133</sup> *Id.*; see also 15 U.S.C. § 78d-1(c) (2014).

<sup>134</sup> *Bandimere v. SEC.*, 844 F.3d 1168, 1180 (10th Cir. 2016); see also 17 C.F.R. § 201.411(b)(2) (2016).

<sup>135</sup> *Bandimere*, 844 F.3d at 1181; see also 5 U.S.C. § 556(c)(6), (8) (2012) (settlement conferences); 17 C.F.R. § 201.155(a) (2015) (default judgments); 17 C.F.R. § 200.30-9 (limiting or suspending sanctions); 17 C.F.R. § 201.531 (2011) (specification of permanent sanctions).

<sup>136</sup> *Bandimere*, 844 F.3d at 1182; *id.* at 1194 (McKay, J., dissenting).

<sup>137</sup> *Id.* at 1182.

<sup>138</sup> *Id.* (quoting *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 285 (D.C. Cir. 2016)).

<sup>139</sup> *Id.* at 1182, 1188. The concurrence was particularly harsh, seemingly admonishing the dissent: "[t]he majority applies precedent: *Freytag*, not *Landry* or *Lucia*." *Id.* at 1189 (Briscoe, J., concurring).

<sup>140</sup> *Id.* at 1183.

<sup>141</sup> *Id.*

[their] duties and discretion.”<sup>142</sup> Thus, the majority viewed the Supreme Court as stating that while the final decision-making authority in the first three categories was enough to make the STJs inferior officers, final decision-making authority was not relied upon for the fourth category.<sup>143</sup> Instead, the Supreme Court looked to the extent of authority and discretion utilized by the STJ in the fourth category, resting its decision on that determination prior to responding to the government’s standing challenge.<sup>144</sup> This interpretation is aptly summed up by the concurrence’s statement that “final decision-making authority might be *sufficient* to make an employee an [o]fficer, [but] that does not mean such authority is *necessary* for an employee to be an [o]fficer.”<sup>145</sup>

The dissent, unpersuaded, continued to focus on the STJs’ “sovereign power to bind the Government and the third parties,” combined with a high level of deference afforded to the STJs as the distinguishing factor between *Freytag* and the present case.<sup>146</sup> This deference was exemplified by the Tax Court being “*required* to presume correct the [STJ’s] factual findings . . . and to defer to the [STJ’s] determinations of credibility.”<sup>147</sup> The dissent saw this as “the difference between chiseling in stone and drafting in pencil.”<sup>148</sup> In support, the dissent noted that the factual findings and legal opinions rendered by the STJs were “routinely adopted verbatim by the regular Tax Court judges to whom they [were] assigned.”<sup>149</sup> In fact, of 880 cases assigned to STJs between 1983 and 2015, the Tax Court had purported to adopt all 880 of those cases verbatim.<sup>150</sup>

This was distinguished from the SEC’s ALJs, where the SEC Commission had only followed the recommendation of the ALJs in three out of thirteen appeals in 2016.<sup>151</sup> Thus, the dissent viewed “the Commission [as] ‘ultimately control[ling] the record for review[ing] and decid[ing] what is on the record,’” because it is the Commission that “enters the final order—in all cases—and it is the commissioners who shoulder the blame.”<sup>152</sup> But the majority found it important that while the SEC may have only followed the recommendation of ALJs in three out of thirteen appeals, about ninety percent of all ALJ decisions “become final without any review or revision from an SEC Commissioner.”<sup>153</sup> Indeed, the SEC itself admitted that it affords ALJs deference, especially in credibility determinations, and as a result engages in “deferential, not *de novo* review of key aspects of its ALJs’ decisions.”<sup>154</sup>

The SEC attempted to add a caveat by stating that “[they] do not view the fact that we accord Commission ALJs deference in the context of demeanor-based credibility determinations to afford our ALJs with the type of authority that would

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<sup>142</sup> *Id.* (quoting *Freytag v. Comm’r*, 501 U.S. 868, 881 (1991)).

<sup>143</sup> *Id.* at 1182-83.

<sup>144</sup> *See id.*

<sup>145</sup> *Id.* at 1192 (Briscoe, J., concurring) (emphasis in original).

<sup>146</sup> *Id.* at 1198 (McKay, J., dissenting).

<sup>147</sup> *Id.* at 1194.

<sup>148</sup> *Id.* at 1195.

<sup>149</sup> *Id.* (internal quotations omitted).

<sup>150</sup> *Id.* at 1198.

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* (quoting *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 288 (D.C. Cir. 2016)).

<sup>153</sup> *Id.* at 1187 (majority opinion).

<sup>154</sup> *Id.* at 1193 (Briscoe, J., concurring).

qualify them as inferior officers.”<sup>155</sup> But, per the concurrence, Bandimere was found liable in “no small part on the United States’s assessment of his credibility during live testimony, credibility determined by the only government employee designated to preside over that testimony—an ALJ.”<sup>156</sup> And while the SEC may sometimes disagree with credibility determinations, the SEC’s own rules still entitled the “ALJ’s evaluation of a witness’s live testimony . . . to ‘considerable weight.’”<sup>157</sup>

As a final note, the majority concluded with a pointed remark towards a large portion of the dissent’s argument: “[E]ven if the STJs exercise more authority than the SEC ALJs, it does not follow that the former are inferior officers and the latter are employees or that the latter do not exercise significant authority. . . . SEC ALJs can still be inferior officers without possessing identical powers as STJs.”<sup>158</sup> With this, the death knell was rung for the SEC’s ALJs; the majority quickly dispatched of the SEC’s other arguments.

### B. Deference to Congress

An additional argument put forth by the SEC urged the Tenth Circuit to “‘accor[d] significant weight’ to [c]ongressional intent in determining whether the ALJs [were] inferior officers.”<sup>159</sup> In support, the SEC stressed that “Congress was ‘deliberate’ in constructing the statutory framework” supporting ALJs, their hiring process, and their powers.<sup>160</sup> The SEC contended that this suggests the congressional intent was for ALJs to be employees.<sup>161</sup> The majority quickly dismissed this, stating that regardless of how careful Congress may have been in devising its statutory scheme, or how effective it may be, it was the court’s place to strike it down if it was unconstitutional.<sup>162</sup> Regardless, the whole argument was beside the point because as a circuit court, the Tenth Circuit was bound to follow Supreme Court precedent, and the majority believed such precedent—*Freytag*—necessitated a result that the SEC’s ALJs were inferior officers.<sup>163</sup>

Further, deference to the workings of the political branches was raised by the government in *Freytag* itself in an attempt at constitutional avoidance, but was rejected by the Supreme Court.<sup>164</sup> There, the Commissioner of Internal Revenue had requested that the Supreme Court defer to the Executive Branch’s own view that the structural interests at issue were solely those of the Executive Branch, and argued that the Supreme Court need not concern itself with the separation of power concerns implicated.<sup>165</sup> In a stern rebuke, the Supreme Court responded that “the Clause forbids Congress to grant the appointment power to inappropriate members of the Executive Branch. Neither Congress nor the Executive can agree to waive this

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<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* at 1187.

<sup>159</sup> *Id.* at 1185.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* at 1186.

<sup>164</sup> *Freytag v. Comm’r*, 501 U.S. 868, 879-80 (1991).

<sup>165</sup> *Id.*

structural protection. . . . The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic.”<sup>166</sup> The Supreme Court then quickly moved on to the application of the Appointments Clause, having easily dispensed with the government’s weak assertion. The majority in *Bandimere* took a similar approach, summarily rejecting the SEC’s deference to Congress argument in favor of honoring Supreme Court precedent.<sup>167</sup>

The dissent briefly acknowledged this argument by quoting the Supreme Court’s statement that “we must hesitate to upset the compromises and working arrangements that the elected branches of Government themselves have reached,”<sup>168</sup> and then espousing the idea that “[i]n a close case regarding the application of a constitutional rule in a discrete factual setting, and without much precedent to guide us, deference to Congress seems particularly relevant.”<sup>169</sup> But the dissent offered no further illumination on its viewpoint, likely due to the weakness of such a position.

### C. “The Probable Consequences of Today’s Decision”

The dissent started its opinion with a dire warning, that this “opinion carries repercussions that will throw out of balance the teeter-totter approach to determining which of all the federal officials are subject to the Appointments Clause.”<sup>170</sup> While the dissent did not believe that *Freytag* “mandate[d] the result . . . here,” it also argued that the result reached by the majority was “too troublesome to risk without a clear mandate from the Supreme Court.”<sup>171</sup> This was based on a fear that every federal ALJ could not be declared an inferior officer, which would “effectively render[] invalid thousands of administrative actions.”<sup>172</sup>

The main crux of the dissent’s argument was its view of a lack of explanation by the majority on what specific duties were important to the declaration that the ALJs exercised enough authority, or how much authority is too much.<sup>173</sup> In the end, the dissent believed that the majority opinion “left . . . more questions than it answer[ed].”<sup>174</sup> The dissent exemplified such concerns by comparing the SEC’s ALJs with those of the Social Security Administration (“SSA”), finding no meaningful differences.<sup>175</sup> With no such meaningful differences, the dissent worried that the SSA would grind to a halt should its ALJs be declared inferior officers in the same vein as the SEC’s ALJs.<sup>176</sup> In fact, the dissent pointed to an Appointment’s Clause challenge to SSA ALJs having already been brought before a court.<sup>177</sup>

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<sup>166</sup> *Id.* at 880.

<sup>167</sup> *Bandimere*, 844 F.3d at 1185-86.

<sup>168</sup> *Id.* at 1201 (McKay, J., dissenting) (quoting *NLRB v. Noel Canning*, 134 S. Ct. 2550, 2560 (2014)).

<sup>169</sup> *Id.*

<sup>170</sup> *Id.* at 1194.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.* at 1199.

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.* at 1199-1200.

<sup>176</sup> *See id.* at 1200.

<sup>177</sup> *Id.* (McKay, J., dissenting) (citing *Manbeck v. Colvin*, No. 15 CV 2132, 2016 WL 29631, at \*1 (S.D.N.Y. Jan. 4, 2016)). Ultimately, the merits of the *Manbeck* case were not reached, as the case was dismissed as moot following the SSA dropping the disciplinary proceedings at issue. 2016 WL 29631, at

The majority quickly swept this issue under the rug, acknowledging that its decision “potentially implicate[d] other questions,” but cautioning that nothing should be “read to answer any but the precise answer before this court: whether SEC ALJs are employees or inferior officers.”<sup>178</sup> Essentially, the majority believed the consequences of the case before them were best left for the future.<sup>179</sup>

The concurrence attempted to add some clarity, calling the dissent’s predictions “exaggerated,”<sup>180</sup> as both *Freytag* and the majority call for a case-by-case determination of officer status, and seek to avoid “sweeping pronouncements” as to the constitutional status of officers and employees.<sup>181</sup> Next, the concurrence rejected the dissent’s suggestion that this opinion would lead to the “implosion of the federal civil service, at least as to all federal ALJs,” and stated that the dissent “unnecessarily sound[ed] the alarm.”<sup>182</sup> Specifically, this focused on the argument that without being considered employees, ALJs would lose their civil service protection of removal for good-cause only.

This concern stems from Supreme Court precedent that some inferior officers are removable only for good-cause, and that double-for-good-cause-removal protection is constitutionally forbidden.<sup>183</sup> Double-for-good-cause-removal protection is created when inferior officer status is layered atop some other good-cause removal procedures. Here, the first layer of for-cause protection would be created by the ALJ’s current removal procedures—by the Merit Systems Protection Board (“MSPB”) for-cause only.<sup>184</sup> The dissent believed the second layer would be created by the removal procedure of the members of the MSPB—also for-cause only.<sup>185</sup> The combined layers of protection would insulate ALJs from both direct removals by a superior officer or the President, as well as removal by manipulation of the MSPB. The dissent feared that as a result of the majority’s holding, either ALJs or the MSPB members would lose their for-cause protection.<sup>186</sup>

This fear was based on *Free Enterprise Fund v. Public Company Accounting Oversight Board*, a Supreme Court case in which dual-for-cause removal protection for members of the Public Company Accounting Oversight Board (“PCAOB”) violated the Constitution.<sup>187</sup> The Supreme Court found that good-cause protection was allowable, but no more than one level of protection can “separate[] the President from an officer exercising executive authority.”<sup>188</sup> Thus, the congressional act that authorized the PCAOB violated the Constitution when it both protected members of the PCAOB from removal without good cause, and vested the ability to determine

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\*1. Further, it is doubtful the issue would have even been discussed in *Manbeck*, as the Court made it clear they would not consider the claim because it was not pleaded in the complaint. *Id.* at \*1 n.1.

<sup>178</sup> *Bandimere*, 844 F.3d at 1188.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.* at 1191 (Briscoe, J., concurring).

<sup>181</sup> *Id.* at 1189.

<sup>182</sup> *Id.* at 1189-90.

<sup>183</sup> See *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 514 (2010).

<sup>184</sup> *Bandimere*, 844 F.3d at 1200 (McKay, J., dissenting).

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> *Id.* (citing *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 492, 525, 542 (2010) (Breyer, J., dissenting)); *Free Enter. Fund*, 561 U.S. at 514.

<sup>188</sup> *Free Enter. Fund*, 561 U.S. at 495.

good-cause in the SEC's Commissioners, who may also only be removed for good-cause.<sup>189</sup>

The concurrence viewed this as a simple fix, for “[a] court faced with such a challenge would be empowered only to order the minimal remedy effective to cure the Article II error, rendering the MSPB’s three members removable by the President at will.”<sup>190</sup> Accordingly, such a result would fix this hypothetical issue without changing the protections the ALJ position currently enjoys.<sup>191</sup> This is similar to the Supreme Court’s decision in *Free Enterprise Fund*. There, the Court rendered the good-cause protection of the PCAOB members invalid, instead allowing them to be removed by the SEC Commission at-will.<sup>192</sup> As a result, the Board members were only separated from the will of the President by one layer of good-cause protection—that of the SEC Commissioners.<sup>193</sup> The concurrence believed a similar result could be reached regarding ALJs, should such a challenge be before the court.<sup>194</sup>

Thus, despite adamant protest from both the SEC and Judge McKay in his dissenting opinion, the Tenth Circuit determined that the SEC ALJ who presided over the administrative hearing in *Bandimere* was an inferior officer of the United States.<sup>195</sup> As a result of this status, the ALJ held his position unconstitutionally, and the SEC’s opinion was vacated.<sup>196</sup>

## VIII. ANALYSIS

After the result of *Bandimere*, a circuit split has been created with regard to the proper interpretation of *Freytag*. This may seem like an easily fixed issue, but the split has potentially huge ramifications. Should the SEC’s ALJs be definitively classified as inferior officers, others who received detrimental rulings by the SEC will be provided with a roadmap for challenging those decisions. With this same challenge popping up across the country, it is quite likely that *Freytag* will continue to be scrutinized by the circuits.<sup>197</sup>

This Note focuses on the narrow issue of the proper interpretation and application of *Freytag*. In the event that this issue is taken up by the Supreme Court, it is likely that *Freytag* will become the centerpiece of this controversy, and will provide a roadmap for other litigants seeking to challenge proceedings before ALJs. Thus, this Note provides an analysis of the result compelled by a proper reading of *Freytag*. Finally, there is a short discussion regarding deference to Congress on this

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<sup>189</sup> *Id.* at 492, 495-96.

<sup>190</sup> *Bandimere*, 844 F.3d at 1191 (Briscoe, J., concurring) (citation omitted).

<sup>191</sup> *Id.*

<sup>192</sup> *Free Enter. Fund*, 561 U.S. at 509.

<sup>193</sup> *Id.*

<sup>194</sup> *Bandimere*, 844 F.3d at 1190 (Briscoe, J., concurring).

<sup>195</sup> *Id.* at 1188.

<sup>196</sup> *Id.*

<sup>197</sup> *See, e.g.*, *Kon v. SEC*, No. 17-CV-2105-JAR-GLR, 2017 WL 1153228 (D. Kan. 2017). In *Kon*, the plaintiff brought a collateral review action to enjoin SEC proceedings on the basis of an Appointments Clause challenge. *Id.* at \*1. However, the Court dismissed the action for lack of subject matter jurisdiction, as district courts lack the authority for collateral review of constitutional challenges. *Id.* at \*11-12. Notably, the Court distinguished this case from *Bandimere*, as *Bandimere* had first raised his Appointments Clause challenge before the SEC prior to seeking judicial review. *Id.* at \*10; *see also* *Bandimere v. SEC*, 844 F.3d 1168, 1171 n.2 (10th Cir. 2016).

issue, and a short note on the importance of circuit splits in gaining the attention of the Supreme Court.

### A. *Interpreting Freytag*

In *Freytag*, the Supreme Court identified three indicia of an inferior officer: (1) that the position was established by law; (2) that the “duties, salary, and means of appointment for that office [were] specified by statute”; and (3) that the purported officer performs “more than ministerial tasks” in an “exercise [of] significant discretion.”<sup>198</sup> When applying this test, the D.C. Circuit and the Tenth Circuit have reached completely opposite results. For the D.C. Circuit, final-decision making power is the level of authority required to be an inferior officer rather than a mere employee.<sup>199</sup> Anything less results in employee status. By contrast, the Tenth Circuit believes that while final decision-making power is sufficient, it is not necessary to be considered an inferior officer.<sup>200</sup> Instead, the level of discretion and the significance of the potential officer’s duties must be adequately weighed.<sup>201</sup>

Of these two possible readings, the Tenth Circuit’s is superior. The D.C. Circuit’s reading is in fact a “truncated framework” that improperly reads the “even if” standing argument as an addition to the primary holding rather than an alternative holding. This reading ignores the clear language of the Supreme Court’s test, and is not consistent with the Supreme Court’s actual application of the test in *Freytag*. While it is true that the D.C. Circuit has a much larger body of case law distinguishing between inferior officers and employees than the Tenth Circuit does, that precedent is based on a misapplication of the *Freytag* test in each successive opinion, reading in final decision-making authority as an additional criterion not present in *Freytag*.

In each of its decisions leading up to *Lucia* in 2016, the D.C. Circuit read the “even if” argument in *Freytag* to be critical to the Supreme Court’s decision. Such a reading ignores the structure of the Supreme Court’s reasoning in *Freytag*. As put forth by the Tenth Circuit in *Bandimere*, the “even if” argument was not a wholly separate holding or an additional criterion.<sup>202</sup> Instead, it was a discrete and separate response to the government’s argument that the petitioner in *Freytag* had no standing to invoke the inferior officer status of the STJs in the first three categories.<sup>203</sup>

Had the “even if” argument been a portion of the Supreme Court’s reasoning as to the inferior officer status, there would have been no reason for severing it from the preceding discussion. In fact, the Supreme Court had declared that the STJs were inferior officers *prior* to even reaching this discussion.<sup>204</sup> The pertinent portion of *Freytag* can be read as two alternative ways to reach the same result. First, there are the three indicia of inferior officer status that the majority used to arrive at its result in *Bandimere*, and second, there is the “even if” argument that can be properly delineated by the structure of the Supreme Court’s reasoning.

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<sup>198</sup> *Freytag v. Comm’r*, 501 U.S. 868, 881-82 (1991).

<sup>199</sup> See *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 285 (D.C. Cir. 2016).

<sup>200</sup> See *Bandimere*, 844 F.3d at 1192 (Briscoe, J., concurring).

<sup>201</sup> *Id.* at 1179-80 (majority opinion).

<sup>202</sup> *Id.* at 1183.

<sup>203</sup> *Id.*

<sup>204</sup> *Freytag*, 501 U.S. at 882.

In its discussion, the Supreme Court stated that the Commissioner of Internal Revenue “reason[ed] that special trial judges may be deemed employees in [the fourth category of] cases because they lack authority to enter a final decision.”<sup>205</sup> In response, the Court stated that “this argument ignores the significance of the duties and discretion that special trial judges possess.”<sup>206</sup> The Court then went on to apply what the Tenth Circuit read as the three indicia of inferior officer status.

In one portion of the Supreme Court’s reasoning, STJs are compared with special masters, who are hired by Article III courts.<sup>207</sup> The Court distinguished between the two by applying the three indicia of officer status, and ended the discussion by stating that “[i]n the course of carrying out . . . important functions, the special trial judges exercise significant discretion.”<sup>208</sup> It is true that the Court does not explicitly state that this line of reasoning led to the determination that STJs are inferior officers. But this result is implicit in the reasoning; otherwise, the Court’s comparison and all the preceding discussion would be moot.

After the Court compared the STJs with special masters, it stated that “[e]ven if the duties of special trial judges under [the fourth category] were not as significant as we and the two courts have found them to be, *our conclusion would be unchanged.*”<sup>209</sup> The final clause makes it clear that the Court had decided the STJs were already inferior officers based on the significance of their duties and authority; otherwise there would be no conclusion to change in the first place. This is likely where the D.C. Circuit’s misinterpretation stems from.

At this point in the *Freytag* opinion, the Supreme Court was addressing the government’s argument that Freytag had no standing “to assert the rights of taxpayers whose cases are assigned to special trial judges” under the first three categories.<sup>210</sup> The ability to assert the rights under the first three categories was important, as the government had conceded that the STJs were inferior officers in regards to those categories on the basis of final decision-making authority.<sup>211</sup> The Court dismissed this argument, as STJs “are not inferior officers for purposes of some of their duties . . . but mere employees with respect to other responsibilities.”<sup>212</sup> Thus, the standing argument was “beside the point,” for “if a special trial judge is an inferior officer for purposes of [the first three categories], he is an inferior officer within the meaning of the Appointments Clause and he must be properly appointed.”<sup>213</sup> Such an assertion, on its own, would lead to a completely reasonable interpretation that final decision-making authority was what led the Court to declare STJs inferior officers. But this statement cannot be read in a vacuum. When read in conjunction with the entirety of the Court’s reasoning on officer status, it is clear that this is somewhat of an alternative argument addressing the absurdities of the government’s concession that the STJs are somehow both inferior officers and

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<sup>205</sup> *Id.* at 881.

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

<sup>208</sup> *Id.* at 881-82.

<sup>209</sup> *Id.* at 882 (emphasis added).

<sup>210</sup> *Id.*

<sup>211</sup> *Id.*

<sup>212</sup> *Id.*

<sup>213</sup> *Id.*

employees.

The Supreme Court rested its decision that the STJs were inferior officers on the application of three indicia of officer status, which looked to the exercise of significant discretion. Thus, as stated in *Bandimere*, final decision-making authority may be sufficient to be considered an inferior officer, but that does not in any way make it necessary.<sup>214</sup>

### B. Deference to Congress

Admittedly, the ability to put forth competing readings helps support the dissent's argument, that the status quo should remain in the absence of a clearer mandate from the Supreme Court. In fact, the dissent argues that deference to Congress is necessary, because when "faced with such uncertainty, [the Court] must hesitate to upset the compromises and working arrangements that the elected branches of Government themselves have reached."<sup>215</sup> But, as noted by Justice Scalia in another case, "the political branches cannot by agreement alter the constitutional structure."<sup>216</sup>

The Supreme Court has consistently read the Appointments Clause not as a mere instructive procedure on how to appoint officers, but as a significant safeguard to the structure of the Republic.<sup>217</sup> And "[n]either Congress nor the Executive can agree to waive this structural protection."<sup>218</sup> The Appointments Clause limits the dispensation of power by Congress, and limits those that may receive such power.<sup>219</sup> This may "not always serve the Executive's interests," but it does protect those of the entire United States.<sup>220</sup>

An argument that the current ALJ structure is somehow a threat to the entirety of the United States may seem a bit hypocritical, "sounding the alarm" in the exact opposite direction from the dissent. But this argument is not put forth in an attempt to claim that the entirety of the administrative law system is unconstitutional, or that ALJ position is not extremely useful. In fact, it is offered for the exact opposite reason. The ALJ position is an extraordinary creation, without which the legal system would likely strain to the point of breaking. Despite this, "the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of the government, standing alone, will not save it if it is contrary to the Constitution. Convenience and efficiency are not the primary objectives—or the hallmarks—of a democratic government."<sup>221</sup> The potential ease of fixes to the ALJ appointment defect makes it all the more important that this issue be solved as quickly as possible to maintain a level of confidence and fairness in the administrative law system.

For example, the Appointments Clause clearly states that the power to appoint inferior officers may be conferred to the head of an administrative agency. As the SEC is an independent agency, the heads of the agency—the Commissioners—

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<sup>214</sup> *Bandimere v. SEC*, 844 F.3d 1168, 1192 (10th Cir. 2016) (Briscoe, J., concurring).

<sup>215</sup> *Id.* at 1201 (McKay, J., dissenting) (quoting *NLRB v. Noel Canning*, 134 S. Ct. 2550, 2560 (2014)).

<sup>216</sup> *Noel Canning*, 134 S. Ct. at 2594 (Scalia, J. concurring in the judgment).

<sup>217</sup> *See supra* notes 57 & 58.

<sup>218</sup> *Freytag*, 501 U.S. at 880.

<sup>219</sup> *Id.*

<sup>220</sup> *Id.*

<sup>221</sup> *INS v. Chadha*, 462 U.S. 919, 944 (1983).

would be able to constitutionally appoint ALJs. Despite this seemingly simple fix, commentators have noted that such actions would be seen as an admission by the SEC that the current ALJ appointments process is unconstitutional, and potentially subject pending and existing SEC orders to new challenges.<sup>222</sup> Despite these challenges, with the ruling in *Bandimere*, and the upcoming *en banc* rehearing in *Lucia*, the SEC will likely be forced to remedy the situation in some manner.

### C. Competing Understandings and the Least Mischief

The *Bandimere* dissent began by stating, in the absence of a clear mandate from the Supreme Court, that it “would prefer the outcome that does the least mischief.”<sup>223</sup> In effect, this would avoid the creation of a circuit split on this important issue. But the presence of a circuit split is one of the most, if not the most, important factors that the Supreme Court considers when deciding whether or not to grant certiorari.<sup>224</sup> In fact, a study of certiorari petitions from 2003 to 2005 showed that of those granted by the Supreme Court, cases involving a conflict of opinion in lower courts ranged from 58.4 percent to 78.9 percent of those in which certiorari was granted.<sup>225</sup> Thus, avoiding “mischief” would seem to be a poor judicial philosophy when a particularly important issue is at hand. This is especially true when the most applicable Supreme Court precedent can arguably be read in two separate manners, even if one reading is clearly more faithful to the actual text of the opinion.

Had Judge McKay’s dissenting preference prevailed, an intra-circuit split would have been created rather than an inter-circuit split. But intra-circuit splits do not create the same probability of certiorari being granted. Instead, the Supreme Court prefers to leave intra-circuit disputes to be resolved from within, as “[i]t is primarily the task of a Court of Appeals to reconcile its internal difficulties.”<sup>226</sup>

While it is true that the existence of a circuit split might be the most important factor in determining whether certiorari may be granted, it is far from the only factor. The Supreme Court also considers cases where lower courts have “decided an important question of federal law that has not been, but should be, settled by [the Supreme Court], or has decided an important federal question in a way that conflicts with relevant decisions of [the Supreme Court].”<sup>227</sup> It is hard to imagine that a decision declaring that administrative law judges require constitutional appointment would not be such an important federal question. Thus, while the existence of a circuit split may be sufficient to catch the attention of the Supreme Court, it is far from necessary. Regardless, higher odds of review are never a poor idea.

In an ideal future, the Supreme Court will take up this issue, and provide a clear

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<sup>222</sup> See Linda D. Jellum & Moses M. Tinchler, *The Shadow of Free Enterprise: The Unconstitutionality of the Securities & Exchange Commission’s Administrative Law Judges*, 70 SMU L. REV. 3, 33-34 (2017).

<sup>223</sup> *Bandimere v. SEC*, 844 F.3d 1168, 1201 (10th Cir. 2016) (McKay, J., dissenting).

<sup>224</sup> H.W. PERRY, JR., *DECIDING TO DECIDE* 246 (First Harv. Univ. Press, 3d ed. 1994) (“Without a doubt, the single most important generalizable factor in assessing certworthiness is the existence of a conflict or ‘split’ in the circuits.”); see also SUP. CT. R. 10, 10(a) (including circuit splits as a “character” of reason considered by the Supreme Court in granting certiorari).

<sup>225</sup> David R. Stras, *The Supreme Court’s Gatekeepers: The Role of Law Clerks in the Certiorari Process*, 85 TEX. L. R. 947, 981-82 (2007) (the statistic excludes any cases that arose under the courts original jurisdiction, three judge panels, or those dismissed as improvidently granted).

<sup>226</sup> *Wisniewski v. United States*, 353 U.S. 901, 902 (1957) (per curiam).

<sup>227</sup> SUP. CT. R. 10(c).

mandate that allows agencies to determine whether the agencies' ALJs are exercising too much power, and if so, to appoint them in a manner that comports with the Constitution.<sup>228</sup> Even if the impending rehearing by the D.C. Circuit, and possible review by the Tenth Circuit, results in the circuit split dissolving, the question of the constitutionality of ALJs in other agencies will not simply vanish. The SEC may remedy the manner in which it appoints ALJs, but as pointed out by the dissent in *Bandimere*, other agencies use ALJs in a significantly similar manner.<sup>229</sup> But at least for the case at hand, the Tenth Circuit has taken the correct first step by putting the SEC on notice that it is using its ALJs in a manner that does not comport with the requirements of the Constitution.

## IX. CONCLUSION

Hopefully, the result in *Bandimere* will begin forcing the SEC to reconsider the constitutionality of its ALJ appointment process. The administrative law system is expansive, and in effect, encompasses the powers of all three branches of government.<sup>230</sup> While the ALJ position may be an amazing creation of American law that allows the United States to function smoothly in an age of constant litigation, the ALJs are not immune from the checks and balances embedded in the Constitution.

Ultimately, a fix is unlikely to significantly alter the functioning of the administrative law system, as demonstrated by the SEC Commissioners simply appointing their own ALJs. While that fix may potentially implicate many other SEC decisions and orders, and is the type of mischief the dissent in *Bandimere* advocated against, the status quo cannot be maintained if it is unconstitutional. It has been noted by another commentator that this argument values form over function, but “[d]isrupting a system that is largely working should factor into the solution,” not determine the constitutionality of that system.<sup>231</sup>

It is true that whatever the solution, many SEC decisions will likely be called into question. Perhaps the SEC should have begun to consider such a possibility when the constitutionality of its ALJs was first called into question in 2015.<sup>232</sup> Instead, the SEC chose to ignore the warning signs, likely bolstered by the friendly result in *Lucia*. But the SEC cannot continue to ignore this issue or kick the can down the road. The SEC, and any other agencies utilizing a similar approach to appointing ALJs, must accept the repercussions of its actions and attempt to move forward. While other approaches to fixing the unconstitutionality of the current ALJ

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<sup>228</sup> See *Bandimere v. SEC*, 844 F.3d 1168, 1181 (10th Cir. 2016), *petition for cert. filed*, No. 17-475 (U.S. Sept. 29, 2017); *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277 (D.C. Cir. 2016), *petition for cert. filed*, No. 17-130 (U.S. July 26, 2017); *Tilton v. SEC*, 824 F.3d 276 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 2187 (2017).

<sup>229</sup> 844 F.3d 1168, 1199-1201 (10th Cir. 2016) (McKay, J., dissenting) (comparing the SEC ALJs with those of the SSA).

<sup>230</sup> Legislative power through rulemaking, executive power through enforcement actions, and judicial power through adjudications.

<sup>231</sup> Jellum & Tincher, *supra*, note 222, at 57.

<sup>232</sup> See *Bebo v. SEC*, 799 F.3d 765, 768 (7th Cir. 2015) (dismissing the claim for lack of subject matter jurisdiction).

appointments process have been put forth,<sup>233</sup> the simplicity of having the agency head appoint the agency's own inferior officers makes the most sense, and would be the easiest to put into practice. But, regardless of the approach taken to remedy this situation, the Tenth Circuit was correct in *Bandimere* to uphold the structure the Constitution put in place.

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<sup>233</sup> See Kent H. Barnett, *Resolving the ALJ Quandry*, 66 VAND. L. REV. 797, 802 (2013) (calling for an inter-branch appointment of ALJs by having an Article III court of law appoint ALJs, thus removing the ability of the executive to remove and possibly influence its own adjudicators).