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What Does The Supreme Court's Lucia Decision Mean For The CFPB And Federal Banking Agencies?

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In its June 21 decision in *Lucia v. Securities & Exchange Commission*, the U.S. Supreme Court ruled that administrative law judges (ALJs) used by the SEC are "Officers of the United States" under the Appointments Clause in Article II of the U.S. Constitution because they exercise "significant authority pursuant to the laws of the United States." Under the Appointments Clause, the power to appoint "Officers" is vested exclusively in the President, a court of law, or the head of a "Department."

In *Lucia*, the plaintiff had challenged the validity of an SEC administrative proceeding in which the ALJ issued a decision finding that he had violated securities laws. Mr. Lucia argued that because the ALJ in his case was appointed by SEC staff rather than the Commission itself, the ALJ's appointment violated the Appointments Clause and made the administrative proceeding invalid. The Supreme Court adopted Mr. Lucia's view, holding that because ALJs perform a number of tasks—conducting trials, managing discovery, writing opinions often adopted as final—the ALJ in his proceeding qualified as an "Officer" under the Appointments Clause and the ALJ's appointment by SEC staff did not satisfy the Appointments Clause.

Going forward, the Supreme Court's Lucia decision will impact all federal agencies that use ALJs for administrative proceedings, including the CFPB and the federal banking agencies. With regard to the CFPB and federal banking agencies, we make the following observations:

CFPB. The CFPB's Rules of Practice for Adjudication Proceedings were modeled on the SEC's Rules of Practice and give an ALJ conducting a CFPB administrative proceeding substantially the same authority as an ALJ used in a SEC proceeding. (The Rules of Practice are the subject of one of the series of RFIs issued by the CFPB.) For example, applying the Supreme Court's *Lucia* analysis, a CFPB ALJ, as does a SEC ALJ, has "the authority needed to ensure fair and orderly adversarial hearings" (for example, to punish an attorney's discovery violations or other contemptuous conduct with exclusion or suspension) and the CFPB Director can decline to review an ALJ decision that has not been appealed. As a result, it is very likely that a CFPB ALJ would be deemed an "Officer" for purposes of the Appointments Clause.

It is worth noting that in the D.C. Circuit's order granting the petition for rehearing en banc in *PHH*, one of the issues the court ordered the parties to address was what the appropriate disposition would be in PHH if the court were to hold in *Lucia* that the ALJ was an "Officer." The initial PHH decision

was issued in 2014 by an ALJ who was on loan to the CFPB from the SEC pursuant to an agreement between the CFPB and SEC. In its opening en banc brief, PHH argued that if the Supreme Court were to hold that the ALJ in *Lucia* was improperly appointed, then the ALJ in its case was also an "Officer" whose appointment violated the Appointments Clause. In its en banc decision in *PHH*, the D.C. Circuit specifically "decline[d]to reach the separate question whether the ALJ who initially considered this case was appointed consistently with the Appointments Clause."

The CFPB's website currently shows the name of an ALJ, Christine Kirby. The CFPB solicited applications for an ALJ in 2015 and presumably Ms. Kirby was appointed as a result of that solicitation while Richard Cordray was still CFPB Director. Our research indicates that all federal agencies hire ALJs through a merit-selection process administered by the Office of Personnel Management (OPM). An agency may select an ALJ from the top three ranked applicants. It is unclear who at the CFPB would have been responsible for selecting and hiring Ms. Kirby from the list of candidates presented by OPM. Clearly, anyone other than Mr. Cordray would not have qualified as the "head of a Department" for purposes of the Appointments Clause.

However, even if Ms. Kirby was hired by former Director Cordray, it is not certain that the CFPB Director would qualify as the "head of a Department." The Dodd-Frank Act provided that "[t]here is established in the Federal Reserve System, an independent bureau to be known as the "[BCFP]." Under U.S. Supreme Court decisions that have addressed the meaning of the term "Department," it is unclear whether an establishment's status as an independent agency with a principal officer who is not subordinate to any other executive officer is sufficient to render it a "Department" or whether it must also be self-contained. While compelling arguments can be made that that the CFPB's status as an independent agency should be sufficient to render it a "Department," Congress' decision to house the CFPB in the Federal Reserve means that the CFPB's status as a "Department" is not free from doubt.

Other than *PHH*, *Integrity Advance* is the only CFPB enforcement matter shown on the CFPB's website in which a decision was issued by an ALJ. Integrity Advance appealed from the ALJ's recommended decision and argued in its appeal that the ALJ's appointment violated the Appointments Clause. (The ALJ was on loan to the CFPB from the Coast Guard.) On March 14, 2018, Acting Director Mulvaney issued an order directing that the case be put on hold and stating that he would determine how the appeal should proceed after the Supreme Court issued its decision in *Lucia*.

Federal Banking Agencies. It appears that the Fed, OCC, FDIC, and NCUA do not have their own ALJs but instead use the same ALJs who are hired by the Office of Financial Institution Adjudication (OFIA). (The OPM's website indicates that the OFIA currently has 2 ALJs.) OCC regulations describe the OFIA as "the executive body charged with overseeing the administration of administrative enforcement proceedings for the [four agencies]." In 2017, the Fifth Circuit ruled that a bank official seeking to stay a FDIC order pending review had shown a likelihood of success on the merits of his argument that the FDIC ALJ was an "Officer" whose appointment violated the Appointments Clause. (The Fifth Circuit subsequently stayed its review pending the Supreme Court's decision in *Lucia*.)

Assuming the ALJs used by the banking agencies would be deemed "Officers" for purposes of the Appointments Clause, the validity of their appointments would depend on (1) how ALJs are hired by the OFIA (*i.e*. are they hired by OFIA or other agency staff or by one or more agency heads), and (2) if ALJs hired by the OFIA are hired by one or more agency heads, whether those agencies qualify as "Departments" for purposes of the Appointments Clause. For example, the OCC might not qualify as

a Department because it is housed in the Treasury Department.

If the ALJs used by the banking agencies were unconstitutionally appointed, it would raise the question of how the agencies must deal with past decision issued by those ALJs. *Lucia* did not overturn all prior decisions issued by SEC ALJs. Instead, the Supreme Court held that only parties who made timely constitutional challenges could request new hearings, which must be overseen by a different ALJ. Last year, the SEC formally ratified the staff appointments of current ALJs to limit the impact of a negative decision in *Lucia*, but the Supreme Court explicitly sidestepped the question of whether that ratification was effective. The CFPB and banking agencies will have to take steps to ensure that they use properly appointed ALJs in future administrative proceedings.

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