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**FINRA AND THE DEVELOPING APPOINTMENTS CLAUSE  
DOCTRINE**

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## I. INTRODUCTION

Since 1948, when Dwight Waldo coined the term ‘The Administrative State,’ there has been debate about the appropriate check on the fourth branch of government agencies.<sup>1</sup> The competing theories of accountability are, on one hand, that the agencies are accountable to the President and, therefore, are agents of an elected principal.<sup>2</sup> Opponents of this view see agencies as legislative bodies that ought to be held accountable to the interest groups that are represented in the regulatory process.<sup>3</sup> While academics and scholars debate which theory of representation would most accurately reflect our democratic republic, the framers of the Constitution built a safeguard within the Appointments Clause.

The Appointments Clause outlines that the President shall nominate, by and with the advice and consent of the Senate, shall appoint *principal* officers.<sup>4</sup> However, 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>5</sup> This dichotomy between principal and inferior officers creates a tripartite of Constitutional positions: principal officer, inferior officer, and non-officers (employees) that fall outside the Appointments Clause.<sup>6</sup> The Appointments Clause is one of the most interesting aspects of political philosophy because of the interplay between the fundamental ideals of separation of powers and interdependency.<sup>7</sup>

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<sup>1</sup> DWIGHT WALDO, *THE ADMINISTRATIVE STATE: A POLITICAL THEORY OF AMERICAN PUBLIC ADMINISTRATION* 90 (Rufus D. Smith & Rinehart J. Swenson eds., 1948) (“In general the claim is that the conditions of the modern world require a large and skilful body of bureaucrats, administrators, or experts . . .”).

<sup>2</sup> See Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2246, 2246 (2001) (explaining how presidential leaderships enhances transparency and creates an electoral link between the public and the bureaucracy).

<sup>3</sup> See generally Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1 (1996) (contrasting collaborative governance with the interest representation theory of administrative law).

<sup>4</sup> U.S. CONST. art. 2, § 2, cl. 2.

<sup>5</sup> *Id.*

<sup>6</sup> John T. Plecnik, *Officers Under the Appointments Clause*, 11 PITT. TAX REV. 201, 207 (2014).

<sup>7</sup> See Matthew Hunter, Note, *Legislating Around the Appointments Clause*, 91 B.U. L. REV. 753, 763 (2011) (“There are essentially three underlying principles: the anti-aggrandizement principle, the accountability principle, and the ‘formalist principle.’ The first two principles seek to directly protect the purposes of the Appointments Clause by protecting separation of powers and ensuring political accountability. The ‘formalist principle’ is not an explicitly articulated principle; rather it is an illustration of an interpretive method that seeks to indirectly protect the purposes of the Appointments Clause through strict adherence to its text.”).

Although it is highly unlikely that the framers could have imagined the size of government today, the Constitution's foundational structure vests Congress with the function of gatekeeper for the appointment of principal and inferior officer, unless otherwise delegated.

Governmental agencies today are complex, intricate, and dauntingly stratified.<sup>8</sup> Usually, a department is tasked with overseeing a generalized area of policy, and within that department are smaller divisions, bureaus, or boards tasked with overseeing specialized areas of policy.<sup>9</sup> For example, the Department of the Treasury is tasked with “[m]aintain[ing] a strong economy and creat[ing] economic and job opportunities by promoting the conditions that enable economic growth and stability at home and abroad, strengthen[ing] national security by combating threats and protecting the integrity of the financial system, and manag[ing] the U.S. Government’s finances and resources effectively.”<sup>10</sup> The Department of the Treasury has delegated specialized functions to: the Alcohol and Tobacco Tax and Trade Bureau; the Bureau of Engraving and Printing; the Bureau of the Fiscal Service; the Community Development Financial Institutions Fund; the Financial Crimes Enforcement Network; the Internal Revenue Service; the Office of the Comptroller of the Currency; and the United States Mint.<sup>11</sup> The heads of these bureaus and offices are appointed by either the President or the Secretary of the Treasury to maintain political accountability.

Modern jurisprudence struggles with determining when an employee exercises such a significant role that the position rises to the level of an inferior office, which requires appointment by the head of the department to ensure accountability to the President.<sup>12</sup> Accountability runs downstream, starting with the public holding the President accountable for the agency's actions, then on to the

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<sup>8</sup> Philip K. Howard, *The U.S. Government Is Too Big To Succeed*, ATLANTIC (Mar. 3, 2012), <https://www.theatlantic.com/politics/archive/2012/03/the-us-government-is-too-big-to-succeed/253920/>.

<sup>9</sup> See Jennifer Nou, *Intra-Agency Coordination*, 129 HARV. L. REV. 421, 423–24 (2015).

<sup>10</sup> *Role of Treasury*, U.S. DEP'T TREASURY, (Apr. 22, 2016, 2:03 PM), <https://www.treasury.gov/about/role-of-treasury/Pages/default.aspx>.

<sup>11</sup> *Organizational Structure*, U.S. DEP'T TREASURY, (June 28, 2013, 12:38 PM), <https://www.treasury.gov/about/organizational-structure/bureaus/Pages/default.aspx>.

<sup>12</sup> *Compare* United States v. Germaine, 99 U.S. 508 (1878), *Auffmordt v. Hedden*, 137 U.S. 310 (1890); *Cain v. United States*, 73 F. Supp. 1019 (N.D. Ill. 1947), *United States v. Schlierholz*, 133 F. 333 (E.D. Mo. 1904), *and* *Nw. Envtl. Def. Ctr., Or., Inc. v. Evans*, No. CIV. 87-229-FR, 1988 WL 360476 (D. Or. Aug. 12, 1988), *with* *United States v. Hartwell*, 73 U.S. 385 (1867), *Silver v. U.S. Postal Serv.*, 951 F.2d 1033 (9th Cir. 1991), *Stanley v. Gonzales*, 476 F.3d 653 (9th Cir. 2007), *and* *Penn. Dep't of Pub. Welfare v. U.S. HHS*, 80 F.3d 796 (3d Cir. 1996).

President holding the agency accountable.

For example, in *Bandimere v. SEC*, the Tenth Circuit determined that the Securities & Exchange Commission's (SEC) Administrative Law Judges (ALJs) were inferior officers.<sup>13</sup> As ALJs are inferior officers, they must be appointed by the Chief ALJ instead of by the Head of the SEC.<sup>14</sup> Because the Chief ALJ did not appoint the ALJs, the court held that the appointment was unconstitutional under the Appointments Clause.<sup>15</sup>

As more challenges under the Appointments Clause arise, Self Regulatory Organizations (SROs) could be caught within the crosshairs. More specifically, Financial Industry Regulatory Authority's (FINRA) Board of Governors and its arbitrators could fall under the purview of the Appointments Clause, dismantling much of the regulatory framework that has existed since 1938.<sup>16</sup> While the judicial treatment of ALJs at the SEC has garnered significant controversy, it does not appear that any jurist or scholar has noted the potentially dramatic implications of those decisions for SROs.

This article will discuss FINRA and the Appointments Clause. Specifically, Part II of this paper will outline the appropriate standard of removal for intra-agency boards, and the test for determining inferior officers, as applied to the Public Company Accounting Oversight Board (PCAOB) and the SEC's ALJs, respectively. Part III will apply these tests to FINRA's Board of Governors and arbitrators to determine their constitutionality due to the lack of appointment by an Appointments Clause actor. Finally, Part IV will conclude that there is a chance that FINRA's Board of Governors and arbitrators will be held unconstitutional if challenged under the Appointment Clause, thus, causing serious uncertainty in the current regulatory scheme.

## II. THE APPOINTMENTS CLAUSE TEST

When analyzing whether a position is constitutional under the Appointments Clause, there are two separate important considerations. The first consideration, applicable only if the position has been appointed by the head of the department, is to determine whether an officer's degree of removal from the President is appropriate in order

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<sup>13</sup> See *Bandimere v. SEC*, 844 F.3d 1168, 1179 (10th Cir. 2016).

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> Joseph McLaughlin, *Financial Services & E-Commerce: Is FINRA Constitutional?*, 12 ENGAGE 111, 111–14 (2011). FINRA is a not-for-profit organization authorized by Congress to protect America's investors by making sure the broker-dealer industry operates fairly and honestly.

to maintain accountability.<sup>17</sup> To maintain the chain of accountability, the President must be able to hold internal subdivisions accountable for their actions.<sup>18</sup> The second consideration, relevant if the position has *not* been appointed by the head of the department, is to distinguish between constitutional officers and employees. When a court determines that a position warrants an employee designation, the analysis ends because the position does not require appointment by a specific actor.<sup>19</sup> When the court holds that a position warrants an officer designation, such a position must be appointed by an actor specified by the Appointment Clause; either the President, the head of a department, or a court of law.<sup>20</sup>

### A. *Free Enterprise Fund*: Removal Standards for Officers

*Free Enterprise Fund v. Public Co. Accounting Oversight Board* establishes the limitations that can be placed on a President's Article II power to remove officers that are exercising executive power.<sup>21</sup> This decision focused on the limitations of congressionally created sub-agencies within an independent agency.<sup>22</sup>

*Free Enterprise Fund* involves a challenge to the SEC's appointment and oversight over the PCAOB. In the Sarbanes-Oxley Act, Congress created the PCAOB.<sup>23</sup> The PCAOB is tasked with registering public accounting firms; establishing standards relating to public company audits; conducting inspections and investigations; and enforcing compliance with the Sarbanes-Oxley Act.<sup>24</sup> The SEC is tasked with appointing and removing board members; approving the budget and creating rules; and entertaining appeals of inspection reports and disciplinary actions.<sup>25</sup>

The Court describes the PCAOB as five members with staggered terms, modeled after SROs in the securities industry, and tasked with investigating and disciplining their own members subject to SEC oversight.<sup>26</sup> Further, comparing the PCAOB to SROs, the PCAOB

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<sup>17</sup> *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 492–93 (2010).

<sup>18</sup> *Id.* at 479.

<sup>19</sup> *Freytag v. Comm'r*, 501 U.S. 868, 880 (1991).

<sup>20</sup> *Id.* at 877.

<sup>21</sup> *Free Enter. Fund*, 561 U.S. 477, 484 (2010).

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

<sup>23</sup> *Id.*

<sup>24</sup> *About the PCAOB*, PUB. COMPANY ACCT. OVERSIGHT BOARD, <https://pcaobus.org/About> (last visited Mar. 28, 2017).

<sup>25</sup> *Id.*

<sup>26</sup> *Free Enter. Fund*, 561 U.S. at 484.

was created “as a private ‘nonprofit’ corporation and [PCAOB] Members and employees are not considered Government ‘officers or employees for statutory purposes.’”<sup>27</sup>

Due to the SEC being an independent agency, its commissioners are only removable by the President after a good cause showing.<sup>28</sup> PCAOB members are shielded from the SEC’s control, and removal can be “only ‘for good cause shown,’ ‘in accordance with’ certain procedures.”<sup>29</sup> The Court states that these procedures are similar to the SEC’s removal of officers and directors of the private SROs.<sup>30</sup> This structure creates a dual, for good cause standard on the removal of the PCAOB’s members.<sup>31</sup>

In an analysis of Article II of the Constitution, the Court provides an instructive background as to why the President’s executive power to remove executive officers is extremely important. Congress can place a good-cause restriction for the removal of principal officers.<sup>32</sup> This restriction comports with the separation of powers concept because it does not fully strip the President of control over the agency.<sup>33</sup> However, the Court held that “the added layer of tenure protection” for the PCAOB “withdraws from the President any decision” regarding supervision.<sup>34</sup> This additional step means that for the President to hold the PCAOB accountable for its actions, he must attempt to hold the SEC Commissioners responsible.<sup>35</sup> However, under the Act’s structure, the Commissioners are not responsible for the PCAOB’s actions due to the elevated “good cause” standard of removal.<sup>36</sup> “The diffusion of power carries with it a diffusion of accountability.”<sup>37</sup>

While some constraints may be placed on the removal of inferior officers, the Court stressed that finality of the removal decision should stay with the principal appointing officers.<sup>38</sup> Due to the judicial review of any efforts to remove PCAOB members, the final say lies

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<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 479.

<sup>29</sup> *Id.* at 486 (quoting 15 U.S.C. § 7211(e)(6) (2010), *declared unconstitutional in part by* Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477 (2010)).

<sup>30</sup> *Id.* at 484.

<sup>31</sup> *See id.* at 492.

<sup>32</sup> *Id.* at 479.

<sup>33</sup> *See id.* at 478–79.

<sup>34</sup> *Id.* at 495.

<sup>35</sup> *Id.* at 495–96.

<sup>36</sup> *Id.* at 486.

<sup>37</sup> *Id.* at 497.

<sup>38</sup> *Id.* at 502.

with the courts, and not with the executive branch.<sup>39</sup> Furthermore, PCAOB members cannot be removed “except for willful violations of the Act, PCAOB Rules, or other securities laws; willful abuse of authority; or unreasonable failure to enforce compliance.”<sup>40</sup> Because of a lack of final say on removal and limited violations that give the Commission power to remove members of the PCAOB, the Court held that these limitations provide unconstitutional insulation from both the principal officer and the President.<sup>41</sup> The Court draws similarities between PCAOB and SROs, which could lead to the same conclusion; that an SRO’s board is unconstitutionally shielded from presidential control.

### **B. *Bandimere v. SEC*: Who is an Officer?**

*Freytag v. Commissioner* is the controlling case for distinguishing between officers and employees. The Supreme Court discussed a couple determining factors to draw a line between an inferior officer and an employee. The test for determining an officer under the Appointments Clause is whether the office is (1) established by law, and the duties, salary, and means of appointment for that office are specified by statute, and (2) vested with “significant authority.”<sup>42</sup> Significant authority consists of (1) authority over important matters; (2) significant discretion; and (3) finality of decisions.<sup>43</sup>

The *Bandimere* court analyzed a challenge to the constitutionality of the SEC’s ALJs and applied the *Freytag* test.<sup>44</sup> This court’s analysis will provide a closer comparison of FINRA’s board of governors and arbitrators.

First the court addressed whether the ALJ position is established by law, and whether the duties, salary, and means of appointment for that office are specified by statute.<sup>45</sup> The Tenth Circuit’s opinion clearly walks through each part of this first step. The Administrative Procedure Act (APA) “created the ALJ position.”<sup>46</sup> Section 556(b)(3) allows for either “(1) the agency; (2) one of the members of the body which comprises the agency; or (3) one or more [ALJs]” to preside at

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<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 493.

<sup>41</sup> *Id.* at 498.

<sup>42</sup> *Freytag v. Comm’r*, 501 U.S. 868, 882 (1991).

<sup>43</sup> *Id.* at 881.

<sup>44</sup> *Bandimere v. SEC*, 844 F.3d 1168, 1171 (10th Cir. 2016).

<sup>45</sup> *Id.* at 1172.

<sup>46</sup> *Id.* at 1176.

the taking of evidence.<sup>47</sup> The duties of SEC ALJs under the APA are included, and expanded upon, in 17 C.F.R. § 201.111. These duties will be further detailed and explained under the “significance” analysis.

The salary for ALJs is determined under 5 U.S.C. § 5372. “The Office of Personnel Management [(OPM)] shall determine . . . the level in which each administrative-law-judge position shall be placed and the qualifications to be required for appointment to each level.”<sup>48</sup> The means of appointment are done so in compliance with 5 U.S.C. § 3105, which allows agencies to “appoint as many [ALJs] as are necessary for proceedings required to be conducted in accordance with [the APA].”<sup>49</sup> “Agencies hire ALJs through a merit selection process administered by the [OPM] which places ALJs within the civil service.”<sup>50</sup> Further, agencies may select from the top three candidates based on the test administered by the OPM.<sup>51</sup> The SEC appoints one chief ALJ, who in turn appoints the other ALJs.<sup>52</sup> The Tenth Circuit thereby concluded that the ALJ position is established by law, and that the duties, salary, and means of appointment are specified by statute.

Next, we look to the significant authority, discretion, and finality analysis. Congress granted the SEC authority to delegate many of its functions to a division of the Commission, an ALJ, or an individual employee.<sup>53</sup> The APA allows ALJs to “have the authority to do all things necessary and appropriate to discharge [their] duties,” part of which is to “conduct hearings.”<sup>54</sup> The court enumerates an exhaustive list of duties that are exercised when conducting hearings, including: administering oaths; determining the scope and form of evidence, rebuttal evidence, and cross-examination; and entering default judgments.<sup>55</sup>

These functions led the court to hold that “ALJs exercise significant discretion in performing ‘important functions’ commensurate with the Special Trial Judge’s (STJ) functions described in *Freytag*.”<sup>56</sup> In carrying out their duties, “ALJs shape the administrative record,” regulate document production, “rule on dispositive and procedural motions,” “issue subpoenas,” and “preside

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<sup>47</sup> *Id.* at 1176 (citing 5 U.S.C. § 556(b)(3) (2012)).

<sup>48</sup> 5 U.S.C. § 5372(b)(2) (2012).

<sup>49</sup> *Bandimere*, 844 F.3d at 1176 (citing 5 U.S.C. § 3105 (2012)).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 1176–77.

<sup>52</sup> 15 U.S.C. § 78d-1(a) (2012).

<sup>53</sup> *Bandimere*, 844 F.3d at 1177 (citing 15 U.S.C. § 78d-1(a) (1987)).

<sup>54</sup> *Id.* (citing 17 C.F.R. § 200.111 (2015); 17 C.F.R. § 200.14 (2015)).

<sup>55</sup> *Id.* at 1178.

<sup>56</sup> *Id.* at 1179.

over trial-like hearings.”<sup>57</sup> Further, ALJs exercise discretion when entering initial decisions.

When SEC ALJs issue an initial opinion, it is reviewable by the Commission.<sup>58</sup> If the Commission does not exercise its right to review an initial opinion, or there is no action from the parties for a review, “then the action of any . . . administrative law judge . . . shall . . . be deemed the action of the Commission.”<sup>59</sup> If the Commission does review an initial decision, it can accept, modify, or reject the decision, in whole or in part.<sup>60</sup> However, the Commission must give deference to the ALJ’s determination of demeanor evidence.<sup>61</sup> The Tenth Circuit highlights that undue weight should not be placed on the element of final decision-making authority.<sup>62</sup> In *Freytag*, the argument that “STJs should be deemed employees when they lacked the ability to enter final decisions ‘ignored the significance of the duties and discretion’ exercised.”<sup>63</sup> This is to say, the last factor of finality, if absent, is not dispositive in the analysis of significant authority.

The Tenth Circuit held that because ALJs exercise “more than ministerial tasks,” they are inferior officers and must be appointed by the President, the head of the department, or a court of law.<sup>64</sup> While this result draws into question previous ALJ decisions, for our purposes it is most important to turn to similar questions related to SROs. It is to that we now turn.

### III. FINRA

The Maloney Act of 1938 amended the Securities Exchange Act of 1934, allowing the creation of SROs to assist the SEC in some aspects of financial regulation.<sup>65</sup> The Exchange Act requires that broker-dealers register with a national securities association in order to participate in the over-the-counter market.<sup>66</sup> In 2007, the sole broker-dealer association, the National Association of Securities Dealers, and the largest exchange, the New York Stock Exchange Member

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<sup>57</sup> *Id.* at 1179–80, 1200.

<sup>58</sup> *Id.* at 1168 n.25.

<sup>59</sup> *Id.* at 1180.

<sup>60</sup> *Office of Administrative Law Judges*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/alj> (last visited Feb. 28, 2017).

<sup>61</sup> *Bandimere*, 844 F.3d at 1180 n.23.

<sup>62</sup> *Id.* at 1182.

<sup>63</sup> *Id.* (citing *Freytag v. Comm’r.*, 501 U.S. 868, 881 (1991)).

<sup>64</sup> *Id.* at 1188.

<sup>65</sup> Jonathan Macey & Caroline Novograd, *Enforcing Self-Regulatory Organization’s Penalties and the Nature of Self-Regulation*, 40 HOFSTRA L. REV. 963, 968 (2012).

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

Regulation, merged to form a single regulatory body known as FINRA.<sup>67</sup>

FINRA is a private, nonprofit corporation that is comprised of sixteen to twenty-five governors who are elected by the regulated members.<sup>68</sup> FINRA's jurisdiction extends to member broker-dealers that involuntarily register, member firms, and associated persons.<sup>69</sup> "Associated persons" are broadly defined as anyone "who is directly or indirectly controlling or controlled by a member."<sup>70</sup>

FINRA works in conjunction with the SEC to protect investors and ensure market integrity. FINRA "performs much of the day-to-day oversight of the securities markets and Broker-Dealers under their jurisdiction. [FINRA is] primarily responsible for establishing standards under which members conduct business; monitoring how that business is conducted; and bringing disciplinary actions against members for violating applicable federal statutes, SEC rules, and [FINRA] rules."<sup>71</sup>

Drawing on the recent decisions of *Free Enterprise Fund* and *Bandimere*, FINRA could face potential challenges to the constitutionality of its structure. Each case independently expands portions of the Appointments Clause and, when read in conjunction, FINRA's actors are drawn within its scope. FINRA's Board of Governors and arbitrators could face challenges regarding unconstitutional removal protection and appointment, which indicates potential regulatory concerns.

When comparing FINRA to PCAOB, there is one main difference that weighs against FINRA's inclusion as a governmental actor, and therefore, not subject to the Appointments Clause. The rest of the factors suggest that the Appointments Clause is relevant, signifying unanticipated consequences. The only difference between these two private, nonprofit corporations is that PCAOB is directly created by Congress, whereas FINRA is indirectly created by Congress due to its registration as an SRO under § 15A of the Exchange Act. If a Court is convinced that FINRA, being the exclusive SRO for broker-dealers, is congressionally created, then its Board of Governors is too insulated

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<sup>67</sup> *Id.* at 968–69.

<sup>68</sup> See *FINRA MANUAL: OFFICIAL PUBLICATION OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY*, FIN. INDUSTRY REG. AUTHORITY, at Art. VII, §§4(a), 13 (2011) (hereinafter *FINRA MANUAL*), [http://finra.complanet.com/en/display/display\\_main.html?rbid=2403&element\\_id=47](http://finra.complanet.com/en/display/display_main.html?rbid=2403&element_id=47) 11.

<sup>69</sup> See *id.* at Art. I, cl. Ff.

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

<sup>71</sup> I.R.S. Chief Couns. Mem. 201623006 (May 2, 2016), <https://www.irs.gov/pub/irs-wd/201623006.pdf>.

from presidential accountability under the *Free Enterprise Fund* holding. Under this analysis, the appointment of arbitrators likely violates the Appointments Clause under the *Bandimere* holding.

### A. Board of Governors

Drawing from the specific language used by the *Free Enterprise Fund* court in comparing PCAOB to SROs, it is likely that the holding would also render FINRA's Board of Governors unconstitutionally insulated. The court held that PCAOB is a "Government-created, Government-appointed entity, with expansive powers to govern an entire industry" even though the PCAOB is not considered part of the government for "statutory purposes."<sup>72</sup> Similarly, the Exchange Act established FINRA and governs the entire industry of broker-dealers, and thus is arguably government-created.<sup>73</sup>

The Act does not specifically call for the creation of FINRA, but FINRA has established itself as the only SRO.<sup>74</sup> While PCAOB's board is government-appointed, FINRA's board is not. This appointment procedure would be subject to a constitutional challenge because FINRA's board exercises "significant authority pursuant to the laws of the United States," and therefore, should require appointment by the President, the head of the department, or a court of law.<sup>75</sup>

Furthermore, FINRA has expansive power to govern the entire industry of Broker-Dealer relations.<sup>76</sup> To understand how deep FINRA's operations run, it is necessary to break it down by division. "FINRA's [Member Regulation] program oversees more than 3,900 brokerage firms, more than 160,000 branch offices and nearly 635,000 registered representatives."<sup>77</sup> Market regulation "monitors approximately 99 percent of the equities market and approximately 70 percent of the options market."<sup>78</sup> In 2016, the enforcement division "brought 1,434 disciplinary actions against registered individuals and firms, and levied \$176.3 million in fines."<sup>79</sup> The Office of Fraud

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<sup>72</sup> *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 484–85 (2010).

<sup>73</sup> I.R.S. Chief Couns. Mem. 201623006, *supra* note 71.

<sup>74</sup> *See* Macey & Novograd, *supra* note 65, at 968–69.

<sup>75</sup> *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

<sup>76</sup> *See* FINRA MANUAL, *supra* note 68, at rt. I, cl. Ff.

<sup>77</sup> *Member Regulation*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/member-regulation> (last visited Feb. 28, 2017).

<sup>78</sup> *Market Regulation*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/market-regulation> (last visited Feb. 28, 2017).

<sup>79</sup> *Enforcement*, FIN. INDUSTRY REG. AUTHORITY,

Detection and Market Intelligence “referred more than 785” matters of potential fraud and misconduct to the SEC.<sup>80</sup> The Division of Dispute Resolution has over 4,000 arbitration cases pending.<sup>81</sup> FINRA also promulgates rules that must be approved by the SEC and issues the qualifying examination that all securities professionals must pass.<sup>82</sup> It is easy to conclude that FINRA has expansive power over the broker-dealer securities industry. Moreover, the Internal Revenue Service has concluded that:

FINRA is a corporation as an agency or instrumentality of the government of the United States . . . when performing its federally mandated duties under the Securities Exchange Act of 1934 . . . [and] conducting enforcement and disciplinary proceedings relating to compliance with federal securities laws, regulations, and FINRA rules promulgated pursuant to that statutory and regulatory authority.<sup>83</sup>

The *Free Enterprise Fund* Court stated that the removal of a Board member from PCAOB is similar to the procedures that govern the Commission's removal of officers and directors of the private self-regulatory organizations.<sup>84</sup> The similar lack of removal power held by FINRA's Board of Governors would subject it to the same reasoning stated in *Free Enterprise Fund*, thus, striking down the two-tiered good cause showing. Where the SEC Commissioners' accountability for PCAOB actions is reduced due to the layered removal standards, the Commissioners have even less accountability for FINRA's actions because not only is there the same high standard for removal, but the Board of Governors are not appointed by the Commission.<sup>85</sup> “The pursuit of policy through a public/private regulator significantly lessens Congress's and the President's accountability to the public because it obscures responsibility for unpopular decisions or unwise

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<http://www.finra.org/industry/enforcement> (last visited Feb. 28, 2017).

<sup>80</sup> *Office of Fraud Detection and Market Information (OFDMI)*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/ofdmi> (last visited Feb. 28, 2017).

<sup>81</sup> *Dispute Resolution Statistics*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics> (last visited Feb. 28, 2017).

<sup>82</sup> *Qualification Exams*, FIN. INDUSTRY REG. AUTHORITY, <http://www.finra.org/industry/qualification-exams> (last visited Feb. 28, 2017).

<sup>83</sup> I.R.S. Chief Couns. Mem. 201623006, *supra* note 71, at 1.

<sup>84</sup> *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 486–87 (2010).

<sup>85</sup> *See id.* at 504–06.

policies.”<sup>86</sup>

For the same reason the *Free Enterprise Fund* court concluded PCAOB’s board were inferior officers, a court could conclude FINRA’s Board of Governors is as well.<sup>87</sup> If the Board of Governors was not appointed by the constitutionally appropriate means, the positions could be vacated and then require reappointment by the Commission. The reclassification of FINRA would disrupt the current regulatory scheme in the securities profession, since FINRA would change from a member elected entity to a government appointed entity.<sup>88</sup> Recognizing FINRA as a governmental entity would subject it to “regulations that constrain the ways in which they hire personnel, compensate their employees, and conduct their operations because of the applicability of laws such as the Freedom of Information Act and the Administrative Procedure Act.”<sup>89</sup> If required to comply with these regulations, the efficiency rationale underlying the creation of SROs would be undercut.

Where FINRA is the only SRO under Section 15 of the Exchange Act,<sup>90</sup> it parallels PCAOB. Therefore, FINRA would likely be required to have both its Board of Governors appointed by the SEC and have the good cause for removal standard struck down.

## B. Arbitrators

If FINRA is established as a governmental actor under the *Free Enterprise Fund* analysis, then its arbitrators would seem to be at risk, because of the *Bandimere* holding that SEC ALJs’ appointments are unconstitutional. There are three types of arbitration that may implicate the arbitrators in different ways: first, a customer suit against a member where the contract may call for mandatory arbitration;<sup>91</sup> second, a member suit against another member where the claim must be brought in arbitration and;<sup>92</sup> and third, a FINRA enforcement action against a member, which is brought before the Office of Hearing

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<sup>86</sup> Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status*, 80 NOTRE DAME L. REV. 975, 1061 (2005).

<sup>87</sup> See M. Todd Henderson & William A. Birdthistle, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1, 61 (2013).

<sup>88</sup> See *id.*

<sup>89</sup> *Id.*

<sup>90</sup> See *On Fixing The Watchdog: Legislative Proposals to Improve and Enhance the SEC: Hearing Before the Committee on Financial Services U.S. House of Representatives*, 112th Cong. 39–41 (2011) (statement of Paul S. Atkins, former Commissioner) (“FINRA has a virtual monopoly on oversight of broker-dealers.”).

<sup>91</sup> FINRA MANUAL, *supra* note 68, at Rule 12200.

<sup>92</sup> *Id.* at Rule 13200.

Officers.<sup>93</sup>

Assuming FINRA is a government agency, there would be an interesting interplay between the APA and the Federal Arbitration Act (FAA). The first two types of arbitration would fall under the FAA, considering the contractual requirement to engage in arbitration. Given the Supreme Court enforcement of, and favoritism towards, arbitration clauses,<sup>94</sup> these types would likely fall outside the Appointments Clause analysis. Also, these types of cases do not include FINRA as an actor.<sup>95</sup> There is little reason to think that in these types of cases the arbitrators would be inferior officers under the Appointments Clause.

However, where FINRA brings an enforcement action against a member, the hearing officers would likely be inferior officers under the Appointments Clause. The hearing officers would operate under the APA if FINRA were a governmental agency<sup>96</sup> and would therefore be subject to the Tenth Circuit's analysis. This section will analyze the Office of Hearing Officers under the Tenth Circuit's analysis and determine whether there is any considerable difference that could cause an alternate result.

Again, the elements in determining whether an employee is an inferior officer are: (1) whether the position is established by law, and the duties, salary, and means of appointment for that office are specified by statute, and (2) vested with "significant authority."<sup>97</sup> Under the assumption that FINRA is a governmental agency for the purpose of the Appointments Clause, it would likely have to follow the rules under the APA.<sup>98</sup> However, if for some reason it does not have to follow the APA guidelines, due to its SRO title, there may still be a good argument to establish that the Office of Hearing Officers are inferior officers. While the hearing officer position is not established by law, the Exchange Act established FINRA and the SEC approves

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<sup>93</sup> *Id.* at Rule 9110.

<sup>94</sup> *E.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 339 (2011); *CompuCredit Corp. v. Greenwood*, 565 U.S. 95, 98 (2012).

<sup>95</sup> *See* *UBS Fin. Servs. v. Carilion Clinic*, 706 F.3d 319, 325 (4th Cir. 2013) (finding that under FINRA Rule 12200, arbitration arises as between a customer and a FINRA member); *see also* *Credit Suisse Sec (USA) LLC v. Tracy*, 812 F.3d 249, 253 (2d Cir. 2016) (finding that under FINRA rule 13200, arbitration arises between FINRA member and associated persons).

<sup>96</sup> *Henderson & Birdthistle*, *supra* note 87 (citing Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formulation*, 47 WASH. & LEE L. REV. 527, 530 (1990)).

<sup>97</sup> *See* *Freytag v. Comm'r.*, 501 U.S. 868, 881 (1991).

<sup>98</sup> *See* *Sequoia Orange Co. v. Yeutter*, 973 F.2d 752, 758 (9th Cir. 1992).

all of FINRA's rules.<sup>99</sup> *Ipsa facto*, the rules have the same weight as law for those members subject to FINRA jurisdiction.<sup>100</sup> The Exchange Act gives registered securities organizations:

[T]he capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the association.<sup>101</sup>

This section establishes FINRA's capacity to create an internal adjudication scheme to enforce the rules, and the Office of Hearing Officers.

The duties, salary, and means of appointment are not necessarily specified by statute, but all are specified in the Federal Register.<sup>102</sup> The duties include, but are not limited to: holding pre-hearing conferences; regulating the course of the hearing; ordering oral arguments; resolving any and all procedural and evidentiary matters; discovery requests and other non-dispositive motions; creating and maintaining the official record; and drafting a decision.<sup>103</sup> The salaries for hearing officers are not listed by statute considering the current private, non-profit corporate structure. However, if the APA applied to these hearing officers, their pay scale would be the same as what the OPM details for ALJs.<sup>104</sup> The means of appointment are almost identical to that of the SEC ALJs, where "the Chief Hearing Officer shall appoint a Hearing Panel or an Extended Hearing Panel to conduct the disciplinary proceeding and issue a decision."<sup>105</sup> While it

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<sup>99</sup> 15 U.S.C. § 78s(b)(1) (2012).

<sup>100</sup> *On Fixing The Watchdog: Legislative Proposals to Improve and Enhance the SEC: Hearing Before the Committee on Financial Services U.S. House of Representatives, supra* note 90 ("While FINRA and other SROs can enact rulemakings that carry the force of law, they are not subject to the Administrative Procedures Act, Freedom of Information Act requests, and are not required to conduct any cost-benefit analyses.").

<sup>101</sup> 15 U.S.C. § 78o-3(b)(2) (2012).

<sup>102</sup> Order Approving Proposed Rule Change Relating to the Adoption of NASD Rules 4000 Through 10000 Series and the 12000 Through 14000 Series, 73 Fed. Reg. 191 (Oct. 1, 2008).

<sup>103</sup> FINRA MANUAL, *supra* note 68, at Rule 9235.

<sup>104</sup> 5 U.S.C. § 5372 (2012).

<sup>105</sup> FINRA MANUAL, *supra* note 68, at Rule 9231(a).

is very tenuous whether the Office of Hearing Officers fully satisfies the first prong of the test, a broadly construed reading of the *Freytag* test could allow new intricacies of the governmental structure to satisfy the prong. A court could place a larger emphasis on the second prong of whether a position that “exercis[es] significant authority pursuant to the laws of the United States is an ‘Officer of the United States.’”<sup>106</sup> Increased importance placed upon the second prong would more easily allow a court to conclude that hearing officers are inferior officers.

The Office of Hearing Officers exercises the same, if not more, authority than the SEC ALJs.<sup>107</sup> Like ALJs, the hearing officers “have authority to do all things necessary and appropriate to discharge his or her duties.”<sup>108</sup> Hearing officers exercise the same authority and discretion as SEC ALJs; the only difference is on the point of finality.

Unless either the respondent or the Department of Enforcement appeals a hearing panel decision to the National Adjudicatory Council (NAC), the decision is final.<sup>109</sup> NAC performs a *de novo* review of the entire record and may take new evidence.<sup>110</sup> While the case is on appeal to the NAC, sanctions are stayed.<sup>111</sup> Unless the Board of Governors decides to review the NAC decision, that decision represents FINRA’s final action.<sup>112</sup> A member may appeal the NAC’s decision to the SEC.<sup>113</sup> The SEC exercises *de novo* review but is required to consider, among other factors, whether the sanction is “excessive or oppressive” and any aggravating or mitigating factors relevant to the determination of an appropriate sanction.<sup>114</sup>

This review process highlights multiple steps of review, by other non-appointed and likely inferior officers, until the appeal reaches the SEC. When the appeal reaches the SEC, the consideration of whether the sanction is excessive or oppressive raises concerns over whether the review is truly *de novo*. Due to this higher standard of review, the finality of the decision is above and beyond the standard of review for an ALJ’s initial decision.<sup>115</sup>

It is possible, for the reasons expressed by the Tenth Circuit, that

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<sup>106</sup> *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

<sup>107</sup> *See Bandimere v. SEC*, 844 F.3d 1168, 1177 (10th Cir. 2016). *See also* FINRA MANUAL, *supra* note 68, at Rule 9235(a).

<sup>108</sup> FINRA MANUAL, *supra* note 68, at Rule 9235(a).

<sup>109</sup> *Id.* at Rule 9311(a).

<sup>110</sup> *Id.* at Rule 9346(a).

<sup>111</sup> *Id.* at Rule 9311(b).

<sup>112</sup> *Id.* at Rule 9351(e).

<sup>113</sup> *Id.* at Rule 9370(a).

<sup>114</sup> *Cody v. SEC*, 693 F.3d 251, 257 (1st Cir. 2012).

<sup>115</sup> *Office of Administrative Law Judges*, *supra* note 60.

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the hearing officers of FINRA would likely be considered inferior officers attributable to their “significant authority pursuant to the laws of the United States” and, therefore, would require proper appointment.<sup>116</sup>

#### IV. CONCLUSION

The increasing complexity of regulatory agencies has caused friction with the Appointments Clause. Agencies have struggled in the delegation of responsibility when engaging in meaningful and compressive regulation and enforcement while also complying with the text of the Constitution. The culpability cannot be solely placed on the agency because, in most instances, the structure is developed by Congress. With the decisions of *Free Enterprise Fund* and *Bandimere*, the scope of positions falling under the Appointments Clause is broadening. If a challenge to FINRA’s constitutionality resulted in the appointment of a significant number of its positions, the SEC would be required to undertake a larger administrative load, further stretching its limited resources. Furthermore, this increase in authority over FINRA could defeat the industry’s self-regulatory scheme since it would become a government-directed regulator. These changes would drastically alter the current regulatory framework and leave the constitutionality of other agency positions in question. While this may not be the worst thing for various reasons, such as political accountability and agency neutrality, this was not what Congress intended when it passed the Maloney Act creating Self-Regulatory Organizations.

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<sup>116</sup> *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

