No. 17-130

IN THE

Supreme Court of the United States

RAYMOND J. LUCIA, *et al.*,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DC CIRCUIT

BRIEF OF RD LEGAL CAPITAL, LLC AND RONI DERSOVITZ AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

ALBERT GIANG
Counsel of Record
DAVID K. WILLINGHAM
MICHAEL D. ROTH
ERIC S. PETTIT
BOIES SCHILLER FLEXNER LLP
725 S. Figueroa Street,
31st Floor
Los Angeles, CA 90017
(213) 629-9040
agiang@bsfllp.com

Counsel for Amici Curiae

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

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INTEREST OF *AMICI CURIAE*[1]

Amicus Curiae RD Legal Capital, LLC ("RDLC"), is a management firm for two hedge funds (the "Funds") launched by *Amicus Curiae* Roni Dersovitz ("Mr. Dersovitz" and, together with RDLC, the "RDLC *Amici*") to raise capital for investments in legal financing. As described in the Funds' offering documents, the Funds seek to generate stable returns for investors, while maintaining capital, through: (a) purchasing from law firms their receivables for legal fees owed; (b) purchasing from plaintiffs their receivables for proceeds from legal judgments or settlements; (c) providing loans to law firms through secured lines of credit; and (d) providing capital to law firms to pursue certain other opportunities that do not fall within the foregoing categories. Since their inception, the Funds have financed and successfully collected more than $400 million spread over more than 2,300 positions originated from attorneys and plaintiffs, and the Funds' wealthy, accredited investors have correspondingly earned compounded double-digit annual returns on their investments.

In March 2015, the Securities and Exchange Commission (the "SEC" or "Commission") began an investigation into whether RDLC and Mr. Dersovitz violated the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The

1. Pursuant to Supreme Court Rule 37.3, *amici* certify that all parties have consented to the filing of this brief. Pursuant to Rule 37.6, *amici* certify that no counsel for a party authored this brief in whole or in part, and no persons other than *amici* or their counsel made a monetary contribution to its preparation or submission.

investigation focused largely on the Funds' investments in assets related to certain receivables arising from a series of consolidated judgment enforcement cases captioned as *Peterson v. Islamic Republic of Iran*, No. 10 Civ. 4518 (KBF), 2013 WL 1155576 (S.D.N.Y. Mar. 13, 2013), *aff'd by Bank Markazi v. Peterson*, 136 S. Ct. 1310, 1317 (2016) ("*Peterson*"). During the investigation, Mr. Dersovitz explained consistently and in detail that he operated within the parameters of the Funds' operating documents, always disclosed the investments in *Peterson*—which he consistently described to investors as the "best trade in the book"—and had the discretion and flexibility to invest heavily in such a strong trade. Moreover, *no investor in the Funds lost any money* in connection with the *Peterson* trades (or any other).

Even though investors profited handsomely from investing in the Funds, the Commission initiated an administrative proceeding against the RDLC *Amici* by filing an Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") on July 14, 2016. *See In the Matter of RD Legal Capital, LLC and Roni Dersovitz*, Administrative Proceeding File No. 3-17342 (July 14, 2016).[2] The proceeding culminated in an administrative hearing before an SEC administrative law judge ("ALJ") that lasted five weeks, involved 43 witnesses, and generated a transcript 7,214 pages long, along with 1,059 individual exhibits. The post-trial briefing involved multiple motions—including on constitutional grounds—and a request by the Commission's Division of

2. All orders from the RDLC *Amici*'s administrative enforcement proceeding are available at https://www.sec.gov/litigation/apdocuments/ap-3-17342.xml.

Enforcement (the "Division of Enforcement") for the SEC ALJ to make factual and credibility findings contained in a 406-page document, consisting of 741 proposed facts, hundreds of sub-facts, and 1,301 factual footnotes. For all intents and purposes, the hearing proceeded as if it were a bench trial presided over by a federal judge.

On August 16, 2017, the SEC ALJ issued an order granting the RDLC *Amici*'s motion for judgment as a matter of law, dismissing the Division of Enforcement's baseless claim that the RDLC *Amici* inappropriately valued the Funds' assets. The SEC ALJ has yet to issue an Initial Decision on the remaining allegations against the RDLC *Amici*.

At multiple stages of the process, the RDLC *Amici* raised constitutional challenges to the administrative proceeding:

- During the pre-hearing phase, the RDLC *Amici* brought a motion to dismiss the administrative proceeding, in part on the ground that SEC ALJs are inferior officers who were not appointed in accordance with the Appointments Clause. The RDLC *Amici*'s Appointments Clause challenge was rejected by the SEC ALJ, however, based on Commission precedent that had consistently (and erroneously) determined that SEC ALJs are mere employees rather than executive officers.

- The RDLC *Amici* also filed a federal action challenging the constitutionality of their administrative proceeding based, *inter alia*, on the Appointments Clause, but the United States

District Court for the District of New Jersey dismissed their complaint on jurisdictional grounds, accepting the Commission's argument that meaningful judicial review of the Appointments Clause issue was available through the administrative process. *See RD Legal Capital, LLC v. SEC*, United States District Court for the District of New Jersey, Case No. 2:16-5104, Order (ECF No. 23), Oct. 20, 2016 (relying on *Jarkesy v. SEC*, 803 F.3d 9, 16 (D.C. Cir. 2015), *Bebo v. SEC*, 799 F.3d 765, 767 (7th Cir. 2015), *Tilton v. SEC*, 824 F.3d 276, 291 (2d Cir. 2016), and *Hill v. SEC*, 825 F.3d 1236, 1252 (11th Cir. 2016)).

- The RDLC *Amici* filed a post-hearing brief in their administrative proceeding that again argued that the SEC ALJ presiding over their proceeding is an officer within the meaning of the Appointments Clause, but had not been constitutionally appointed. While that motion was pending, the Commission reversed its position on the constitutional status of its ALJs, and now agrees that its ALJs are executive officers and not mere employees. On November 30, 2017, however, the Commission purported to ratify the prior appointment of its ALJs in a misguided attempt to "put to rest" any Appointments Clause challenge. *See* Order, *In re Pending Administrative Proceedings*, Securities Act Release No. 10,440, 2017 WL 5969234, at *1 (Nov. 30, 2017) ("Ratification Order").

- The RDLC *Amici* then filed briefs before the SEC ALJ arguing, *inter alia*, that the Ratification Order did not cure the Appointments Clause

> infirmity. On February 23, 2018, however, the SEC ALJ issued an order stating that the Commission's Ratification Order cured any Appointments Clause infirmity. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 5625 (ALJ Feb. 23, 2018).

Thus, like Petitioners before them, the RDLC *Amici* are respondents in an administrative proceeding presided over by an SEC ALJ who has exercised significant authority and whose hiring violates the Appointments Clause of the United States Constitution. The RDLC *Amici* accordingly have a direct and substantial interest in the outcome of this case, and urge the Court to conclude that: (1) SEC ALJs are "Officers of the United States" within the meaning of the Appointments Clause, but were not appointed in conformity with the Appointments Clause; and (2) the Commission cannot cure the Appointments Clause violations by "ratifying" the unconstitutional delegation of its responsibility to appoint SEC ALJs, or by asking SEC ALJs to reconsider and ratify decisions on their own constitutional status that they made prior to being appointed in a constitutional manner.

SUMMARY OF ARGUMENT

Prior to the passage in 2010 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), the Commission was statutorily prohibited from bringing administrative proceedings seeking financial penalties against unregistered entities such as the RDLC *Amici*, and was required to pursue those penalties against unregistered entities in federal court. While Dodd-Frank lifted that legislative restriction, it did not and

could not eliminate the constitutional infirmities of SEC administrative proceedings presided over by SEC ALJs who were not appointed in the manner prescribed by the Appointments Clause in Article II of the United States Constitution.

SEC ALJs perform functions and exercise responsibilities akin to federal judges presiding over bench trials. SEC ALJs make important pretrial rulings, control the discovery process, and have considerable discretion over whether to permit dispositive motions. SEC ALJs, moreover, are charged with admitting and distilling the evidence, and making factual and credibility findings, to compile an administrative record that, even if appealed, is afforded considerable deference. SEC ALJs thus control virtually every aspect of the administrative proceedings over which they preside. The administrative proceeding against the RDLC *Amici* is a case in point.

In Section I of this brief, the RDLC *Amici* provide an account of the SEC administrative proceeding against them to illustrate that SEC ALJs do, in fact, exercise significant authority that has a profound impact on litigants and on the financial viability of small businesses like RDLC. It is evident from the RDLC *Amici*'s case (and other such cases) that SEC ALJs exercise the kind of governmental authority that makes them executive officers subject to the Appointments Clause.

In Section II, the RDLC *Amici* explain that the Commission's belated attempt to unwind its constitutional violations by "ratifying" the process by which its ALJs were hired by the SEC's Chief ALJ distorts the ratification doctrine and runs counter to the non-delegable mandate

of the Appointments Clause. *See Buckley v. Valeo*, 424 U.S. 1, 118, 125-26 (1976) (per curiam) (the Appointments Clause establishes the "*exclusive* method by which those charged with executing the laws of the United States may be chosen") (emphasis added). Similarly, the Commission's instruction that its ALJs revisit and ratify actions that they took in pending administrative proceedings prior to being constitutionally appointed cannot remove the unconstitutional stain from those proceedings.

ARGUMENT

I. SEC ALJS EXERCISE "SIGNIFICANT AUTHORITY" OVER EVERY PHASE AND FACET OF AN SEC ADMINISTRATIVE PROCEEDING

Before the Court is the question of whether SEC ALJs are "Officers of the United States" within the meaning of the Appointments Clause in Article II of the Constitution. Although a deadlocked *en banc* panel of the D.C. Circuit in this case upheld an earlier panel opinion answering that question in the negative, *every other federal court* to have considered the question has held that SEC ALJs are "Officers of the United States" subject to the Appointments Clause because, under the standard articulated by this Court in *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868 (1991), they exercise "significant authority" over SEC administrative enforcement proceedings. *See Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016), *petition for cert. filed* (U.S. Sept. 29, 2017) (No. 17-475); *Ironridge Glob. IV, Ltd. v. SEC*, 146 F. Supp. 3d 1294 (N.D. Ga. 2015), *appeal dismissed*, No. 16-10205 (11th Cir. Sept. 27, 2016); *Duka v. SEC*, 103 F. Supp. 3d 382 (S.D.N.Y 2015), *vacated on other grounds*, No. 15-2732 (2d Cir. June 13,

2016); *Gray Fin. Grp., Inc. v. SEC*, 166 F. Supp. 3d 1335 (N.D. Ga. 2015), *vacated on other grounds sub nom. Hill v. SEC*, 825 F.3d 1236 (11th Cir. 2016); *Hill v. SEC*, 114 F. Supp. 3d 1297, 1316-19 (N.D. Ga. 2015), *rev'd on other grounds,* 825 F.3d 1236 (11th Cir. 2016); *cf. Burgess v. FDIC*, 871 F.3d 297, 299-301 (5th Cir. 2017) (staying order by Federal Deposit Insurance Corporation ("FDIC") based on finding that appellant was likely to succeed on his claim that the FDIC ALJ who presided over his proceeding was an "inferior Officer" subject to—but not appointed consistently with—the Appointments Clause).

The RDLC *Amici* respectfully submit that a "case study" of their experience over the last nineteen months vividly illustrates the significant authority that SEC ALJs wield over every phase and facet of an administrative enforcement proceeding. This control is not limited to the power to issue what may become a final order imposing significant penalties at the conclusion of the hearing, but also includes the authority to make decisions at every stage of the administrative hearing process that, as a practical matter, can have a profound impact on the development of the record and the ultimate outcome of the proceeding.

A. The SEC ALJ Exercised Significant Authority over Important Prehearing Issues in the RDLC *Amici*'s Administrative Proceeding

Following a nearly two-year investigation, the Commission initiated an administrative proceeding against the RDLC *Amici* by filing an OIP on July 14, 2016. *See In the Matter of RD Legal Capital, LLC and Roni Dersovitz*, Administrative Proceeding File No. 3-17342 (July 14, 2016). The OIP asserts complicated

securities fraud claims and seeks tens of millions of dollars in damages against the RDLC *Amici*, as well as the imposition of a lifetime industry bar, which has been called the "securities industry equivalent of capital punishment." *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007). The Commission, however, elected not to prosecute its claims in federal court, where the RDLC *Amici* would have the due process protections of the Federal Rules of Civil Procedure and the Federal Rules of Evidence, broad discovery rights, and the opportunity to present their defenses to a jury. Instead, the Commission decided to give itself a literal "home court" advantage by bringing an administrative enforcement proceeding before an SEC ALJ.

The Commission's decision to have its claims against the RDLC *Amici* heard by an SEC ALJ rather than an Article III judge is not surprising. "The SEC won against 90% of defendants before its own judges in cases from October 2010 through March [2015]," which is "markedly higher than the 69% success rate the agency obtained against defendants in federal court over the same period." Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J., May 6, 2015. The Commission accordingly has a powerful incentive to keep claims—particularly marginal claims such as those it asserted against the RDLC *Amici*—out of federal court, where they may not survive even the pleadings stage, and instead litigate those claims in a more favorable and forgiving forum. *Cf. SEC v. Mapp*, 240 F. Supp. 3d 569, 593 (E.D. Tex. 2017) (dismissing SEC enforcement action for a second time on the pleadings, with prejudice, based on conclusion that "[a]s alleged, [defendant's] conduct simply does not give rise to liability under the federal securities laws as they exist today

[, a]nd it is not the province of the Court to stretch federal securities laws beyond their scope to prescribe liability based on moral considerations or policy concerns").

One of the reasons the Commission's "home court" advantage in administrative enforcement proceedings is so strong is that its ALJs wield significant authority regarding virtually every aspect of the proceedings over which they preside, including at the prehearing stage. As explained below, rulings made—or refused to be made—by the SEC ALJ at the prehearing stage of the case against the RDLC *Amici* had a major impact on the ability of the RDLC *Amici* to prepare their defenses and, later, to present those defenses in order to have meritless claims dismissed.

1. The SEC ALJ Declined to Require That the OIP Provide Sufficient Notice of the Commission's Fraud Claims

Because the Federal Rules of Civil Procedure do not apply in SEC enforcement proceedings, the Division of Enforcement was not required to plead its fraud claims with particularity as required by Rule 9 of the Federal Rules of Civil Procedure. Faced with an OIP that lacked the particularity necessary for the RDLC *Amici* to adequately prepare their defenses, the RDLC *Amici* invoked the only procedural mechanism available under the SEC's Rules of Practice, and filed a Motion for a More Definite Statement. *See* 17 C.F.R. § 201.220(d) (Rule 220(d)). The SEC ALJ, however, simply declined to rule on the motion, forcing the RDLC *Amici* to defend themselves against fraud charges without notice of the "who, what, where, or when" of the Commission's fraud allegations.

2. The SEC ALJ Issued Discovery Rulings That Impeded Preparation of the RDLC *Amici*'s Defenses

In addition to declining to rule on a motion to clarify the pleadings, the SEC ALJ further prevented the RDLC *Amici* from preparing their defense against the Commission's case by issuing several rulings that curtailed the RDLC *Amici*'s access to discovery.

The Commission filed the OIP following a prolonged investigation, during which the RDLC *Amici* cooperated fully with the Division of Enforcement, producing approximately one million pages of documents. In conducting its investigation, the Commission also: (a) obtained testimony from five of RDLC's employees, as well as from certain third parties, including the independent valuation firm for the Funds; (b) had the ability to take unlimited *ex parte* testimony of witnesses, backed by national subpoena power; (c) received approximately one million pages of additional documents in response to third-party subpoenas; and (d) contacted and interviewed dozens of investors. The Commission had three Division of Enforcement staff attorneys working on the matter consistently throughout the investigation, and up to five staff members attending the testimony in the case—sometimes double- or triple-teaming witnesses during questioning without defense counsel present.

In contrast to the extensive investigative powers available to—and exercised by—the Commission, the RDLC *Amici*'s access to and time for discovery was significantly limited by the SEC ALJ's rulings. The SEC ALJ set a discovery, motion, and hearing schedule

that required hearing preparation—including review of more than two million pages—on an expedited basis. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4237 (ALJ Oct. 7, 2016). The hearing—initially set for a mere month after the OIP was issued—was continued for only seven months for the RDLC *Amici* to review and analyze the Commission's massive document production, conduct their own discovery, and prepare their defense. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 3988 (ALJ July 15, 2016); *RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4086 (ALJ Aug. 23, 2016).

In addition to the voluminous number of documents it collected during the investigation, the Division of Enforcement sought and obtained leave from the SEC ALJ to issue additional document subpoenas to RDLC and others during the administrative proceeding—which the SEC ALJ herself acknowledged was "unusual." *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4387 (ALJ Nov. 23, 2016). Moreover, during the prehearing process, the Division of Enforcement served an initial witness list that identified more than fifty witnesses—many of whom appeared to have no connection to the case. Under 17 C.F.R. § 201.233(a)(2) (Rule 233(a)(2)), the RDLC *Amici* (with permission from the SEC ALJ) were permitted to depose just *five* witnesses collectively.[3] The RDLC *Amici*

3. The allowance of five depositions was the result of the 2016 amendments to the SEC's Rules of Practice, which, by agreement of the parties, apply to the administrative proceeding for the RDLC *Amici*. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4036 (ALJ Aug. 2, 2016).

felt compelled to devote some of their five depositions to depose certain of these "mystery" witnesses in order to determine the substance of their testimony, only to find that most of those witnesses were not included in the Division of Enforcement's final witness list. And when the RDLC *Amici* requested that the SEC ALJ grant them leave to take the maximum number of two additional depositions allowed under 17 C.F.R. § 201.233(a)(3) (Rule 233(a)(3)), the SEC ALJ initially granted leave for the depositions, *see RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4499 (ALJ Jan. 4, 2017), only to later quash two of the deposition subpoenas—including one to a key witness because of the witness's vacation schedule. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4526 (ALJ Jan. 13, 2017).

3. The SEC ALJ Declined to Permit a Dispositive Motion by the RDLC *Amici* before Being Replaced on the Eve of the Hearing

The SEC ALJ also prevented the RDLC *Amici* from narrowing the issues prior to the hearing. On the evening that discovery closed—*i.e.*, the very first opportunity for filing a dispositive motion based on lack of evidence—the RDLC *Amici* filed a request to bring a dispositive motion on the ground that the Commission had no evidentiary support for one of its two theories of liability (*i.e.*, that the RDLC *Amici* had improperly valued the assets in the portfolios of the Funds they manage). So that the motion could be heard before the administrative hearing commenced under the expedited scheduling order the SEC ALJ had issued, the RDLC *Amici* agreed to waive their

right to submit a reply brief. The SEC ALJ nonetheless determined that the motion was untimely. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4622 (ALJ Feb. 23, 2017) at 1 ("The request [for leave to file a motion for summary disposition] will be denied as untimely.").

The SEC ALJ's refusal to entertain the RDLC *Amici*'s dispositive motion—despite the fact that it was filed on the very day discovery closed—denied the RDLC *Amici* the opportunity to streamline the case against them, and forced them to devote substantial time and resources before and during the hearing to defend against a claim that was wholly lacking in merit or evidentiary support. The SEC ALJ's refusal to entertain a motion to dismiss the Commission's baseless valuation claim prior to the hearing was devastating to the RDLC *Amici*'s business, as the public allegation that the company was cooking its books was damning to the RDLC *Amici*'s reputations, and the SEC ALJ prevented the RDLC *Amici* from clearing their names from the Commission's meritless smears.

In a remarkable twist, on March 9, 2017—one day after the RDLC *Amici* filed their prehearing briefs and less than two weeks before the start of the administrative proceeding—the Commission, without any explanation, assigned a new SEC ALJ to preside over the administrative hearing. *See RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4670 (ALJ Mar. 9, 2017). The RDLC *Amici* asked the newly appointed SEC ALJ to entertain a dispositive motion on the valuation issue following the close of evidence at the administrative hearing. After initially denying the motion, the SEC ALJ issued an order on August 16, 2017 granting

summary dismissal of the Commission's valuation claims and confirming that the "valuation allegations are unfounded. . . ." *RD Legal Capital, LLC*, SEC Admin. Proc. File No. 3-17342, Rulings Release No. 4976 (ALJ Aug. 16, 2017) at 1; *see also id.* at 15 ("Having carefully scrutinized the Division's recitation of all evidence on this issue, I find that, as a matter of law, its allegations on valuation amount to nothing.").

The dramatic reversal in the fortunes of the Commission's damaging yet meritless valuation claim following the assignment of a new SEC ALJ highlights the significant discretion and authority that individual SEC ALJs exercise in the administrative enforcement proceedings over which they preside. Moreover, as the RDLC *Amici*'s case illustrates, an SEC ALJ's exercise of its discretion and authority can have severe economic and practical consequences for litigants forced to defend themselves in those proceedings.

B. The SEC ALJ Exercised Significant Authority During the RDLC *Amici*'s Five-Week Administrative Hearing

The administrative hearing against the RDLC *Amici* was held from March 20, 2017 through April 27, 2017. It was presided over by an SEC ALJ in a courtroom at the United States District Court for the Eastern District of New York. Forty-three witnesses testified during the trial, and the transcript spans 7,214 pages. The ALJ admitted 1,059 exhibits into evidence. To any of the dozens of witnesses who testified, to the reporters who covered the hearing, and to the spectators who attended, as well as to the parties and their counsel, there was no question that the SEC ALJ, sitting on the bench in a black robe, controlling the

proceeding, and making dozens of rulings on a daily basis, was exercising significant governmental authority.

The SEC ALJ made countless rulings during the proceeding, including on, among other things: the propriety of questioning; the admissibility of each exhibit; the competency of witnesses (including a *Daubert* challenge by the RDLC *Amici* that was granted, in part); the ramifications of alleged *Brady* and *Jencks* violations; the production of additional documents; and dozens of administrative issues. The SEC ALJ also administered oaths to every witness, questioned certain witnesses himself, directed counsel to question witnesses about certain topics, and generally controlled the course of the hearing. In addition, the SEC ALJ ruled on many motions brought by both parties—including the Division of Enforcement's motions to preclude certain affirmative defenses or find a waiver of the attorney-client privilege, multiple motions for a directed verdict in favor of the RDLC *Amici* (one of which was ultimately granted), and the RDLC *Amici*'s motions to dismiss the proceeding on several constitutional grounds, including based on violations of the Appointments Clause.

Following the proceeding, the parties filed multiple post-trial briefs, and the Division of Enforcement submitted 406 pages of proposed findings of fact, requiring the SEC ALJ to make factual and credibility determinations on 741 individual proposed facts and hundreds of sub-facts.

The importance of the SEC ALJ's gatekeeping role in compiling such a massive administrative record and preparing an Initial Decision is indisputably significant. As a practical matter, there is no way the Commission—in

the event it is called upon to review the forthcoming Initial Decision—could review *all of the evidence* submitted in the RDLC *Amici*'s five-week trial without the filter and gloss of the ALJ's Initial Decision, and it certainly could not make the important credibility determinations that the SEC ALJ presiding over the administrative proceeding is uniquely positioned to make. Indeed, during the course of the *Lucia* case, the Commission even acknowledged that an SEC ALJ's determination has "considerable importance," because the ALJ is "in the best position to make findings of fact, including credibility determinations, and resolve any conflicts in the evidence." Pet. App. 241a; *see also* Brief for Petitioners ("Pet'rs Brief"), at 24; Brief for Respondent Supporting Petitioners ("Top-Side Brief"), at 24; *In re Clawson*, Exchange Act Release No. 48,143, 2003 WL 21539920, at *2 (July 9, 2003) ("We accept [an SEC ALJ's] credibility finding, absent *overwhelming evidence* to the contrary.") (emphasis added). Thus, if there was any doubt about the authority afforded to an SEC ALJ in an administrative proceeding, the SEC ALJ's responsibility to compile an administrative record, analyze the reams of evidence submitted by both parties, and eventually issue an Initial Decision that will receive deference if subject to review, confirms that SEC ALJs exercise significant authority.[4]

4. In contrast, if SEC ALJs were truly SEC "employees" who lack independent discretion but preside over administrative proceedings anyway—as the Commission previously asserted—then the Commission is acting through its agents as both prosecutor and judge, adding to the significant due process problems that already plague SEC administrative proceedings. *See Williams v. Pennsylvania*, 136 S. Ct. 1899, 1905 (2016) ("[A]n unconstitutional potential for bias exists when the same person serves as both accuser and adjudicator in a case.").

II. THE COMMISSION'S RATIFICATION ORDER PERPETUATES ITS FLOUTING OF THE APPOINTMENTS CLAUSE

On November 30, 2017—one day after the Solicitor General admitted in a brief filed on the Commission's behalf that SEC ALJs exercise significant authority and thus are executive officers under the Appointments Clause—the Commission issued the Ratification Order, which sought "[t]o put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause." *See* Order, *In re Pending Administrative Proceedings*, Securities Act Release No. 10,440, 2017 WL 5969234, at *1 (Nov. 30, 2017).

The Ratification Order employs two separate "ratification" strategies to achieve its objective. First, the Ratification Order states that "the Commission—in its capacity as head of a department—hereby ratifies the agency's prior appointment of Chief Administrative Law Judge Brenda Murray and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes, and Jason S. Patil." *Id.* Second, the Ratification Order requires all SEC ALJs presiding over pending matters to "[r]econsider the record" and to "[d]etermine, based on such reconsideration, whether to ratify or revise in any respect all prior actions taken by an administrative law judge in the proceeding . . . ." *Id.* at 1-2.

As explained below, however, *neither* of these two components of the Ratification Order can cure the constitutional defects in SEC administrative enforcement proceedings. The Ratification Order does not and

cannot change the fact that the Commission violated the Appointments Clause when it forced the RDLC *Amici* and other respondents to participate in administrative enforcement proceedings presided over by individuals who had not been appointed by the Commission. Those violations warrant dismissal of *all* administrative enforcement proceedings conducted before an unconstitutional SEC ALJ, as the Commission cannot cure through ratification structural defects in the constitutionality of those proceedings. *See Edmond v. United States*, 520 U.S. 651, 659 (1997) ("[T]he Appointments Clause of Article II is more than a matter of 'etiquette or protocol'; it is among the significant structural safeguards of the constitutional scheme.") (citing *Buckley v. Valeo*, 424 U.S. 1, 125 (1976) (per curiam)).[5]

5. In addition to failing to cure the Appointments Clause violations, the Ratification Order does not address, let alone attempt to remedy, the separation-of-powers infirmity caused by the multiple layers of tenure protection afforded to SEC ALJs. As this Court held in *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 492 (2010), Article II requires that executive officers not be protected from removal by their superiors at will when those superiors are themselves protected from removal by the President at will. *See also id.* at 483-84 (holding that "multilevel protection from removal is contrary to Article II's vesting of the executive power in the President"). SEC ALJs, however, enjoy multiple layers of protection from removal, which—as in *Free Enterprise Fund*—impairs the President's ability to ensure that the laws are faithfully executed. *See id.* at 498. Because the President cannot oversee SEC ALJs in accordance with Article II, administrative proceedings presided over by those judges violate separation-of-powers principles embedded in the Constitution. *See* Top-Side Brief, at 39-45.

A. The Commission Cannot Ratify Prior "Appointments" of Its SEC ALJs

The Commission's attempt to retroactively "ratif[y] the agency's prior appointment" of its SEC ALJs is ineffective because *there were no prior appointments to ratify*. As the Commission concedes, it abdicated its constitutional obligation to appoint SEC ALJs in favor of a hiring process that delegated to the Chief SEC ALJ and the Commission's Office of Human Resources the task of vetting and selecting SEC ALJs. The Commission cannot use the ratification doctrine to rewrite history and magically transform an unconstitutional delegation of hiring authority into a "prior appointment." Indeed, the Commission's attempted ratification perpetuates, rather than cures, its Appointments Clause violations because the ratification doctrine, by its nature, presupposes the ability of a principal to delegate authority to an agent, and the delegation of appointment authority is the very thing that the Appointments Clause prohibits.

1. Ratification Cannot Convert a Hiring into an Appointment

The Commission's attempt to cure the Appointments Clause violations by "ratif[ying] the agency's prior appointment" of SEC ALJs must fail because, as the Commission itself has conceded, none of the SEC ALJs were ever "appointed" by the agency. The ALJs currently employed by the Commission instead were vetted through a competitive examination process conducted by the Office of Personnel Management, and ultimately were selected not by the Commission, but by the Chief SEC ALJ, "subject to approval by the Commission's Office of

Human Resources on the exercise of authority *delegated* by the Commission." Top-Side Brief at 3 (emphasis added); *see also id.* at 38.

This accordingly is not a situation where the Commission sought in good faith to appoint SEC ALJs in a manner consistent with the Appointments Clause but made some mistake that rendered the appointments constitutionally defective. To the contrary, prior to its recent conversion, the Commission long eschewed any obligation to appoint SEC ALJs, and instead argued vehemently for years that SEC ALJs were "employees" who were not, and did not need to be, appointed in accordance with the Appointments Clause. *See, e.g.*, *Bandimere*, 844 F.3d at 1176 (acknowledging the Commission's concession that SEC ALJs "are not appointed" in conformity with the Appointments Clause). Thus, despite how it is described in the Ratification Order, the Commission's effort to retroactively convert a constitutionally infirm delegation of hiring authority into a constitutionally permissible appointment process would not be a *ratification* of the Commission's prior acts, but rather a *mischaracterization* of those acts. A ratification can confirm that an apple is an apple, but it cannot transform an apple into an orange. Or, put another way, the Ratification Order cannot ratify something that *did not happen*.

2. The Ratification Doctrine Has No Relevance Here

The ratification doctrine arises out of principles of agency law. *See FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994) (analyzing whether Solicitor General could retroactively authorize filing of certiorari petition,

and noting that "[t]he question is at least presumptively governed by principles of agency law, and in particular the doctrine of ratification"). "Ratification is the affirmance of a prior act done by another, whereby the act is given effect *as if done by an agent acting with actual authority*." Restatement (Third) of Agency § 4.01 (2006) (emphasis added); *see also GDG Acquisitions LLC v. Gov't of Belize*, 849 F.3d 1299, 1310 (11th Cir. 2017) ("[T]he doctrine of ratification starts with the assumption that the agent did not have actual authority at the time he acted.").

The ratification doctrine thus *presupposes* that a principal has the power to authorize an agent to act on its behalf, and is designed to address situations where the agent did not have such authorization from the principal at the time the agent acted. *See Marsh v. Fulton Cty.*, 77 U.S. (10 Wall.) 676, 684 (1870) (ratification "operates upon the act ratified in the same manner as though the authority of the agent to do the act existed originally"). As one court described:

> Ratification results when a principal affirms a previous unauthorized act by his agent. The effect of ratification is to give the principal's agent the authority to perform the unauthorized act as of the time the agent performed the unauthorized act. In essence, ratification by a principal of his agent's unauthorized act is equivalent to the agent having that particular authority from the beginning.

In re Packer Ave. Assocs. v. Johnstone, 1 B.R. 286, 292 (Bankr. E.D. Pa. 1979) (citation omitted); *see also GDG Acquisitions*, 849 F.3d at 1310 ("It is precisely on account

of the principal's subsequent consent that the prior unauthorized act 'is given effect as if done by an agent acting with actual authority.'") (quoting Restatement (Third) of Agency § 4.01(1)).

Here, however, the Appointments Clause violations were not the result of the Chief SEC ALJ hiring SEC ALJs without "actual authority" from the Commission. To the contrary, the undisputed facts leave no doubt that the Commission affirmatively sought to delegate[6] to the Chief SEC ALJ the authority to hire SEC ALJs, and thus, from an agency law perspective, the Chief SEC ALJ had "actual authority" to make those hiring decisions on behalf of the Commission. *See* Restatement (Third) of Agency § 2.01 (2006) ("An agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, *the agent reasonably believes, in accordance with the principal's manifestations to the agent, that the principal wishes the agent so to act.*") (emphasis added).

Instead, the Appointments Clause places constitutional limits on the *Commission's* ability to delegate to an agent authority to act on the Commission's behalf when it comes to appointing "Officers of the United States" such as SEC ALJs, and it was the *act of delegation*, not the *absence of actual authority*, that caused the constitutional violations. The ratification doctrine the Commission purports to rely on to cure its Appointments Clause violations accordingly has no relevance here, and cannot be used to permit

6. While the Commission has taken the position that it delegated its appointment power to the Chief SEC ALJ, it is not clear that it followed the proper procedure to do so. *See* 15 U.S.C. 78d-1(a) (requiring the Commission to delegate its functions only "by published order or rule").

the Commission to accomplish, *mutatis mutandis*, the delegation of authority that the Appointments Clause expressly prohibits. *See District Twp. of Doon v. Cummins*, 142 U.S. 366, 376 (1892) ("[A] ratification can have no greater effect than a previous authority."); *see also* Cal. Civ. Code § 2312 (West 2018) ("A ratification is not valid unless, at the time of ratifying the act done, the principal has power to confer authority [to an agent] for such an act."); *Stowe v. Maxey*, 84 Cal. App. 532 (Cal. Ct. App. 1927) (holding board of supervisors having no authority to delegate power to corporation to hold county fair could not ratify corporation's action thereunder).

3. The Ratification Order Itself Violates the Appointments Clause

The Commission can *never* confer upon its Chief SEC ALJ—whether in the first instance or through ratification—the authority to appoint other SEC ALJs. That appointment power is conferred by the Appointments Clause exclusively to the commissioners themselves, as the head of a department under the Constitution. *See* U.S. Const. Art. II, § 2, cl. 2 (dictating that inferior officers must be appointed by the President, the head of a department, or a court of law); *Free Enter. Fund*, 561 U.S. at 512-13 (commissioners are the "head of a department" for purposes of Appointments Clause); *Buckley*, 424 U.S. at 118 (holding that the Appointments Clause establishes the "*exclusive method* by which those charged with executing the laws of the United States may be chosen") (emphasis added).

Because its prior delegation of hiring authority is the very thing that the Appointments Clause prohibits, the Commission does not have the power to ratify such improper delegation retroactively. This Court has recognized that "it is *essential* that the party ratifying should be able . . . *to do the act ratified*," both "at the time the act was done" and "*at the time the ratification was made*." *NRA Political Victory Fund*, 513 U.S. at 98 (first two emphases added) (quoting *Cook v. Tullis*, 85 U.S. (18 Wall.) 332, 338 (1874)). In *NRA Political Victory Fund*, the Court rejected the Solicitor General's attempt to ratify the filing of a *certiorari* petition by the Federal Election Commission on the ground that the Solicitor General itself lacked authority at the time of its purported ratification to do the act that it sought to ratify. *See* 513 U.S. at 98 ("Here, the Solicitor General attempted to ratify the FEC's filing on May 26, 1994, but he could not himself have filed a petition for certiorari on that date because the 90-day time period for filing a petition had expired on January 20, 1994. His authorization simply came too late in the day to be effective.").

As in *NRA Political Victory Fund*, the Commission here itself lacks the authority to do the act it seeks to ratify—*i.e.*, delegation of the selection and hiring of SEC ALJs to others. The Commission's attempt in the Ratification Order to accomplish through retroactive "ratification" that which it lacks the constitutional authority to do in the first place accordingly must be rejected. *See Newman v. Schiff,* 778 F.2d 460, 467 (8th Cir. 1985) ("Ratification serves to authorize that which was unauthorized. Ratification cannot, however, give legal significance to an act which was a nullity from the start."). Indeed, by reaffirming through the Ratification Order its prior authorization of the Chief SEC ALJ's

prior acts, the Commission persists in flouting its constitutional obligations, and compounds rather than cures its Appointments Clause violations. *See* Order, *In re Pending Administrative Proceedings*, Securities Act Release No. 10,440, 2017 WL 5969234, at *1 (Nov. 30, 2017) (purporting to ratify the "agency's prior appointment" of SEC ALJs). This Court accordingly should find that the Ratification Order itself violates the Appointments Clause, and that the RDLC *Amici* and all other respondents in pending administrative proceedings are entitled to new proceedings before constitutionally appointed officers.

4. The RDLC *Amici* Are Unaware of Any Instance in Which an Appointments Clause Violation Has Been Cured Through Ratification

In a brief filed in the administrative proceeding against the RDLC *Amici*, the Commission's Division of Enforcement cited several cases that it claimed support the Commission's ability to cure any Appointments Clause violations by ratifying the Chief SEC ALJ's prior hiring decisions. *See CFPB v. Gordon*, 819 F.3d 1179 (9th Cir. 2016); *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111 (D.C. Cir. 2015); *Doolin Sec. Sav. Bank, F.S.B. v. Office of Thrift Supervision*, 139 F.3d 203 (D.C. Cir. 1998); *FEC v. Legi-Tech*, 75 F.3d 704 (D.C. Cir. 1996). In each of these cases, however, the Appointments Clause violation was cured not through a retroactive ratification of a *defective prior* "appointment" (as the Commission improperly attempts to do in its Ratification Order), but rather through a two-step process in which a *valid subsequent* appointment permitted the now properly appointed officer to ratify prior unauthorized acts.

In *CFPB v. Gordon*, for example, Director Richard Cordray was not able to ratify his prior unauthorized acts as Director of the Consumer Finance Protection Bureau until he was subsequently confirmed by the Senate. 819 F.3d at 1185-86; *see id.* at 1190–91 ("The initial invalid appointment of Cordray also is not fatal to this case. The *subsequent valid appointment*, coupled with Cordray's August 30, 2013 ratification, cures any initial Article II deficiencies.") (emphasis added). Notably, the Senate did not seek to ratify Director Cordray's previous improper recess appointment—the equivalent of what the Commission is attempting to do with its Ratification Order. The Senate instead undertook a constitutional appointment process, and Director Cordray, once properly appointed, was then able to ratify his prior unauthorized acts. The Appointments Clause dictated that there be a constitutionally sound appointment prior to Director Cordray ratifying his otherwise unauthorized acts. *See Buckley*, 424 U.S. at 125.

Similarly, each of the three D.C. Circuit ratification cases the Division of Enforcement relied on involved ratification of prior acts *following* a subsequent valid appointment, *not* the ratification of a prior hiring or "appointment" that was made in violation of the Appointments Clause. *See Intercollegiate Broad.*, 796 F.3d at 117 ("Intercollegiate does not dispute that the three new Judges were properly appointed by the Librarian under the Appointments Clause."); *Doolin*, 139 F.3d at 213-14 (D.C. Cir. 1998) (holding that a *validly appointed agency director* had "made a detached and considered judgment" in ratifying the previous director's decision); *FEC v. Legi-Tech*, 75 F.3d at 706 (holding that a *properly reconstituted* Federal Election Commission could reauthorize pending

enforcement actions that had been initiated by an unconstitutionally constituted Commission).

These cases, even if properly decided, accordingly provide no support for the Commission's improper effort to retroactively ratify a selection and hiring process for SEC ALJs that even the Commission now concedes violated the Appointments Clause, and the RDLC *Amici* are unaware of any case holding that an Appointments Clause violation can be cured through ratification in the absence of a subsequent valid appointment. This lack of supporting precedent for the Commission's position makes sense given that—as explained above—ratification is an agency law doctrine that permits a principal to confirm that it has delegated to its agent the authority to act, but has no bearing on whether the principal has the constitutional authority to make such a delegation in the first place. As it relates to the appointment of "Officers of the United States," this second question is answered by the Appointments Clause itself, and the answer is no.

B. SEC ALJs Cannot Ratify Prior Denials of Appointments Clause Challenges

The Commission's instruction in the Ratification Order requiring SEC ALJs to "[r]econsider the record" and to "[d]etermine . . . whether to ratify or revise in any respect all prior actions" likewise does not cure its Appointments Clause violations. As a threshold matter, for all of the reasons articulated in Petitioners' Brief, a citizen subjected to proceedings before an unconstitutionally appointed adjudicator is entitled to entirely new proceedings before an executive officer appointed in conformity with the Appointments Clause. *See* Pet'rs Brief

at 43-49. Moreover, while the Commission undeniably has the authority to appoint individuals to serve as SEC ALJs, the Commission has not exercised that authority—in the Ratification Order or elsewhere—to appoint the current SEC ALJs. And even if the Commission were to appoint the current SEC ALJs and could simply order them to revisit their prior rulings—a procedure that has never been endorsed by this Court—those SEC ALJs would have no choice but to *reverse* their prior denials of Appointments Clause challenges because, as the Commission itself now concedes, the SEC ALJs had not been properly appointed at the time that those challenges were brought, and those challenges accordingly were—and continue to be—meritorious.

1. The Ratification Order Fails to Appoint the SEC ALJs in the Manner Required by the Appointments Clause

The RDLC *Amici* recognize that the Commission has authority as the "head of a department" to appoint SEC ALJs in conformity with the Appointments Clause. *Free Enter. Fund*, 561 U.S. at 512-13 (commissioners are the "head of a department" for purposes of Appointments Clause). The Commission, however, has not yet exercised that authority. As discussed above, the Ratification Order instead improperly attempts to ratify a prior act that violated the Appointments Clause. While the Ratification Order goes on to instruct SEC ALJs to "[r]econsider" and "ratify or revise" all prior actions, it *fails to appoint* the SEC ALJs in the manner required by the Appointments Clause, and thus never imbues the SEC ALJs with the authority necessary to engage in that process. Moreover, as explained below, even if the Commission

were to subsequently exercise its authority to appoint the SEC ALJs, prior motions to dismiss administrative proceedings—such as the ones repeatedly filed by the RDLC *Amici*—should have been granted.

2. Even Properly Appointed SEC ALJs Could Not Ratify Prior Denials of Appointments Clause Challenges

This Court has never endorsed the ratification of adjudicative acts by an unconstitutionally appointed adjudicator, but the D.C. Circuit has held that a properly appointed official can revisit and ratify prior adjudicative acts taken by an improperly appointed official. *Compare Ryder v. United States*, 515 U.S. 177, 188 (1995) (reversing judgment by Coast Guard Court of Military Review based on Appointments Clause violation and holding that "[p]etitioner is entitled to a hearing before a properly appointed panel of that court") *with Intercollegiate Broad.*, 796 F.3d at 117-18 (allowing ratification of decision of unconstitutionally constituted Copyright Royalty Board). Even if *Intercollegiate* were correctly decided, however—a point that is far from clear under *Ryder* and this Court's Appointments Clause jurisprudence—the "ratifier" cannot just "blindly affirm the earlier decision without due consideration," but instead "must make a detached and considered affirmation of the earlier decision." *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 602-03 (3d Cir. 2016); *see also Wilkes-Barre Hosp. Co., LLC v. NLRB*, 857 F.3d 364, 371 (D.C. Cir. 2017) ("Our precedents establish that ratification can remedy a defect arising from the decision of 'an improperly appointed official . . . when . . . a properly appointed official *has the power to conduct an independent evaluation*

of the merits and does so.'") (emphasis added) (quoting *Intercollegiate Broad.*, 796 F.3d at 117-21, 124).

Here, an independent reevaluation of the merits of prior constitutional challenges brought by the RDLC *Amici* and other respondents would require dismissal of the tainted proceedings. In the administrative proceeding for the RDLC *Amici*, for example, each time the SEC ALJ rejected the Appointments Clause challenges, he did so solely on the ground that he lacked authority to contravene the Commission's prior (erroneous) determination that SEC ALJs were not "inferior officers" subject to the Appointments Clause. Now, however, the Commission has reversed its position, and agrees that the RDLC *Amici*'s administrative proceeding was presided over by an "inferior officer" who was not appointed in conformity with the Appointments Clause. Thus, in the absence of an impermissible "blind affirmance," there is no way for the SEC ALJ to conclude that the RDLC *Amici*'s motions to dismiss based on Appointments Clause violations should not have been granted at the time they were brought.

This Court has recognized that proceedings before an improperly appointed judge must be set aside. *See, e.g.*, *Ryder*, 515 U.S. at 188 (holding Appointments Clause violation "entitled [petitioner] to a hearing before a properly appointed" court); *Nguyen v. United States*, 539 U.S. 69, 77-83 (2003) (rejecting the "*de facto* officer" doctrine and vacating judgments based on determination that a Ninth Circuit panel consisting of two Article III judges and one Article IV judge lacked authority to decide the appeals); *see also Bandimere*, 844 F.3d at 1172, 1188 (setting aside Commission's opinion based on Appointments Clause violation and

recognizing that resolving the Appointments Clause challenge in petitioner's favor "relieves Mr. Bandimere of all liability"). SEC administrative enforcement actions where a citizen's assets and very livelihood are at stake are exactly the type of proceedings that involve the exercise of significant governmental authority, and those proceedings accordingly *must* be set aside if they are not presided over by a duly appointed officer. Actions taken by an SEC ALJ who has not been appointed in accordance with the Appointments Clause accordingly are *void ab initio*, and cannot be transmogrified into official acts by later ratification.

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"Ratification" is not a magical incantation that can be wielded indiscriminately to transform what the Commission now concedes was a constitutionally improper hiring process into a proper exercise of the Commission's authority under the Appointments Clause. And any *subsequent* valid appointment would not change the fact that, at the time the RDLC *Amici* challenged the constitutionality of their administrative proceeding, the SEC ALJs presiding over the proceeding had not been appointed in the manner required by the Appointments Clause, and the motions to dismiss the unconstitutional proceeding therefore *should have been granted*.

CONCLUSION

The Commission was well aware at the time that it issued its OIP against the RDLC *Amici* of the multiple pending challenges to the constitutionality of its administrative enforcement proceedings, including

challenges based on the Appointments Clause. Instead of filing its case in federal court and avoiding those issues, however, the Commission commenced an administrative proceeding against the RDLC *Amici*, fought the RDLC *Amici*'s constitutional challenges in multiple venues, and assumed the risk that the Appointments Clause issue would ultimately be decided against the Commission. Having assumed that risk and subjected the RDLC *Amici* and other citizens to prolonged proceedings that lacked the constitutional safeguards mandated by Article II, the Commission cannot wipe away its own constitutional violations with a simple stroke of the pen. Our Constitution demands more. *See Edmond v. United States*, 520 U.S. 651, 659 (1997) ("[T]he Appointments Clause of Article II is more than a matter of 'etiquette or protocol'; it is among the significant structural safeguards of the constitutional scheme.") (citing *Buckley*, 424 U.S. at 125).

Respectfully submitted.

Albert Giang
Counsel of Record
David K. Willingham
Michael D. Roth
Eric S. Pettit
Boies Schiller Flexner LLP
725 S. Figueroa Street,
31st Floor
Los Angeles, CA 90017
(213) 629-9040
agiang@bsfllp.com

Counsel for Amici Curiae

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