UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Administrative Proceedings Rulings
Release No. 5603 / February 15, 2018

Administrative Proceeding
File No. 3-17950

In the Matter of

David Pruitt, CPA

Order Denying Motion for Stay

Respondent David Pruitt, CPA, has filed a renewed motion for a stay. He argues that a stay is warranted because the Securities and Exchange Commission changed its position in litigation about the constitutionality of the appointment of its administrative law judges. Pruitt also asserts that the Commission failed to remedy the constitutional problems that infect this proceeding. The Division of Enforcement opposes Pruitt's motion. For the reasons discussed below, Pruitt's motion is denied.

As is well known, the Commission has faced challenges over the last three years about whether the Commission's administrative law judges are inferior officers who must be appointed by the Commission rather than by Commission staff to whom it delegates its appointment authority.[1] Respondents have argued that the Commission's administrative law judges are inferior officers who were not properly appointed under the Appointments Clause, *i.e.*, by the Commissioners themselves acting as "the Head[] of [the] Department[]."[2] The Commission has disagreed, asserting that its administrative law judges are "employees, not constitutional Officers."[3] After

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[1] *See, e.g.*, *Hill v. SEC*, 114 F. Supp. 3d 1297 (N.D. Ga. 2015), *vacated*, 825 F.3d 1236 (11th Cir. 2016).

[2] *E.g.*, *Harding Advisory LLC*, Advisers Act of 1940 Release No. 4600, 2017 WL 66592, at *19 (Jan. 6, 2017), *petition filed*, No. 17-1070 (D.C. Cir. Mar. 6, 2017); *see* U.S. Const. art. II, § 2, cl. 2.

[3] *Harding Advisory*, 2017 WL 66592, at *19.

prevailing on the question of whether respondents could go straight to district court to stop an administrative proceeding,[4] the Commission's record on the merits of the Appointments Clause issue has been mixed.[5] The Commission's hand was finally forced, however, when the Solicitor General conceded on November 29, 2017, that the Commission's administrative law judges are inferior officers.[6]

Following the Solicitor General's concession, the Commission decided "[t]o put to rest any claim that administrative proceedings pending before, or presided over by, Commission administrative law judges violate the Appointments Clause."[7] It thus "ratifie[d] the agency's prior appointment of" its five administrative law judges and directed them to take certain actions.[8] About six weeks later, the Supreme Court granted the petition in *Lucia*.[9]

Discussion

Pruitt contends that the Commission's ratification order didn't fix anything. First, Pruitt argues that "the Commission cannot ratify an unconstitutional act."[10] He adds that the Commission could remedy the Appointments Clause defect by appointing its administrative law judges "itself and delivering a commission to them."[11] Second, he asserts that the multiple layers of tenure protection that insulate administrative law judges

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4 *E.g.*, *Bennett v. SEC*, 844 F.3d 174 (4th Cir. 2016).

5 *Compare Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016), *reh'g denied*, 855 F.3d 1128 (2017), *petition for cert. filed*, No. 17-475 (U.S. Sept. 29, 2017), *with Raymond J. Lucia Cos. v. SEC*, 868 F.3d 1021 (D.C. Cir. 2017) (en banc) (per curiam), *cert. granted*, 86 U.S.L.W. 3356, 2018 WL 386565 (U.S. Jan. 12, 2018) (No. 17-130).

6 Brief for the Respondent at 9–10, *Lucia v. SEC*, No. 17-130 (U.S. filed Nov. 29, 2017) (Solicitor General's Brief).

7 *Pending Admin. Proc.*, Securities Act of 1933 Release No. 10440, 2017 WL 5969234, at *1 (Nov. 30, 2017).

8 *Id.* at *1–2.

9 *Lucia v. SEC*, 86 U.S.L.W. 3356, 2018 WL 386565 (U.S. Jan. 12, 2018) (No. 17-130).

10 Mem. at 3.

11 *Id.* at 5.

also violate the Constitution.[12] Based on these arguments, he renews his motion to stay.[13]

The Appointments Clause

As to the Appointments Clause, Pruitt argues "there is no prior agency appointment to ratify because the Commission played no role in the ALJs' original selection."[14] Pruitt says that instead, the Office of Personnel Management (OPM) ranked prospective candidates and the Commission's chief administrative law judge interviewed the three candidates ranked highest by OPM, "and made a preliminary hiring selection, subject to processing by the Commission's Office of Human Resources."[15] Based on these factual allegations, Pruitt says that because neither the President, nor the courts, nor the head of any department "played any role in selecting the ALJs initially," the Commission was barred by the Appointments Clause "from delegating [its] authority to the Chief ALJ at the outset."[16]

Pruitt also cites *Marbury v. Madison*[17] and argues that the Appointments Clause prevents the Commission from "retroactively ratifying the results of" the hiring procedure he describes, "without conducting its own review of the candidates and delivering a commission to its appointees."[18]

Pruitt's premise and legal conclusions are mistaken. Accepting Pruitt's premise that the Commission's chief administrative law judge interviewed me and made a hiring recommendation, the Commission's ultimate appointing authority in my case was exercised by the Commission's Chief

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12 *Id.* at 6–9.

13 *Id.* at 9–10. Pruitt alternatively asks for dismissal. Because there is no basis to grant that request, it is denied.

14 *Id.* at 5.

15 *Id.* (internal quotation marks omitted).

16 *Id.*

17 5 U.S. (1 Cranch) 137 (1803).

18 Mem. at 5–6.

Human Capital Officer following my execution of an "appointment affidavit."[19]

As to his legal conclusions, Pruitt misunderstands principles of agency law and the requirements of the Appointments Clause. According to the Restatement of Agency, a principal may ratify an agent's prior action.[20] Indeed, a principal may ratify the action "of a person who purported to be an agent but was not."[21] A principal's "ratification retroactively creates the effects of actual authority."[22] To make ratification effective, the principal must manifest, in some way, its consent to the action being ratified.[23] The

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[19] As one might guess, the appointment is evidenced on a Standard Form 50 and the referenced appointment affidavit is reflected on a Standard Form 61. The hiring process in which OPM ranks candidates for selection by agencies applies to me but not to three of my four colleagues, including the administrative law judge whose appointment is the subject of the *Lucia* petition. *See* https://www.sec.gov/news/press/2011/2011-96.htm; Solicitor General's Brief at 3; *see also* 5 C.F.R. § 930.201(e) (providing that "OPM does not hire administrative law judges," and instead may "[r]ecruit and examine [administrative law judge] applicants"). If OPM's ranking of eligible candidates is relevant to the Appointments Clause analysis, that ranking is not directly at issue in *Lucia* and is thus not a reason to stay this proceeding.

[20] Restatement (Third) of Agency § 4.03 (2006); *see Arriaga v. Fla. Pac. Farms, LLC*, 305 F.3d 1228, 1245 (11th Cir. 2002) ("When applying agency principles to federal statutes, 'the Restatement (Second) of Agency … is a useful beginning point for a discussion of general agency principles.'"); *see also Mark E. Laccetti, CPA*, Exchange Act Release No. 78764, 2016 WL 4582401, at *7 (Sept. 2, 2016) (stating that "principles of agency law . . . inform [the Commission's] analysis" of a ratification challenge), *petition filed*, No. 16-1368 (D.C. Cir. Oct. 26, 2016).

[21] Restatement (Third) of Agency § 4.03 (2006).

[22] *Id.* at § 4.02; *see G & R Corp. v. Am. Sec. & Trust Co.*, 523 F.2d 1164, 1171 (D.C. Cir. 1975) (citing Restatement (Second) of Agency § 82 (1958)); *see also Marsh v. Fulton Cty.*, 77 U.S. (10 Wall.) 676, 684 (1870) ("A ratification is, in its effect upon the act of an agent, equivalent to the possession by him of a previous authority. It operates upon the act ratified in the same manner as though the authority of the agent to do the act existed originally.").

[23] Restatement (Third) of Agency § 4.01.

question of whether a principal manifested the necessary consent is a factual question.[24]

Here, given the position she holds, the Chief Human Capital Officer is the Commission's delegate and agent for purposes of appointing agency officials. In its ratification order, the Commission explicitly stated that it was "ratif[ying] the agency's prior appointment of" its five administrative law judges.[25] This makes answering the factual question of the principal's intent easy; by the language in its order, the Commission plainly manifested its consent to and approval of the prior appointments of its administrative law judges, in whatever form those appointments may have taken. And by doing so, it retroactively cloaked the Chief Human Capital Officer's appointment of me in the Commission's own authority.[26] To the extent Pruitt suggests that, as a matter of agency law, the Commission cannot ratify my appointment because the Commissioners were not personally involved in the process that led to my appointment by the Chief Human Capital Officer, he is mistaken.[27]

Putting agency law aside, Pruitt suggests that the Appointments Clause requires some level of involvement by the Commissioners in the interview and selection of administrative law judges.[28] The Constitution, however, says nothing about the procedure for selecting inferior officers for

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[24] *Dist. Nat'l Bank v. Maiatico*, 60 F.2d 1078, 1079 (D.C. Cir. 1932).

[25] *Pending Admin. Proc.*, 2017 WL 5969234, at *1–2.

[26] Restatement (Third) of Agency § 4.02; *see* Restatement (Second) of Agency § 82. Pruitt does not dispute that the Commission had at all relevant times the authority to appoint its administrative law judges. *See FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994) ("it is essential that the party ratifying should be able not merely to do the act ratified at the time the act was done, but also at the time the ratification was made") (quoting *Cook v. Tullis*, 85 U.S. (18 Wall.) 332, 338 (1874)); *see also Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 511 (2010) ("the Commission is a . . . 'Departmen[t]' for the purposes of the Appointments Clause").

[27] Indeed, adopting Pruitt's position would turn concepts of agency law on their head by requiring the principal to have been involved in the original decision to be ratified. But if principals could only ratify actions in which they were involved, there would be no need to ratify anything and the concept of ratification would be meaningless.

[28] *See* Mem. at 5–6 (arguing that the Appointments Clause required the Commission to "conduct[] its own review of the candidates" for appointment).

appointment.[29] It also does not bar the President or heads of departments from delegating to subordinates the function of selecting inferior officers for appointment. And the Constitution says nothing about whether candidates for appointment may be limited to those with certain specified qualifications.[30] Instead, it only requires that the named officials do the actual appointing.[31]

Requiring some level of involvement by the President or heads of departments in the interviewing and selection of inferior officers would grind the business of the President and the executive branch to a halt. Take military officers, for example. Commissioned military officers are all officers of the United States whose initial appointments and later promotions must conform with the Appointments Clause.[32] The President plays no role, however, in the selection of officers for direct appointment in the regular service in grades O-3 and below.[33] Instead, the President has by executive order delegated to the Secretary of Defense his authority to directly appoint such officers.[34] And Congress has crafted an elaborate process through which

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[29] *See* U.S. Const. art. II, § 2, cl. 2.

[30] For example, there are statutory requirements for many officer and inferior officer positions subject to the Appointments Clause. *Cf., e.g.*, 28 U.S.C. § 631(b) (listing the qualifications for magistrate judges); 42 U.S.C. § 205 (describing the qualifications for appointment as Surgeon General).

[31] U.S. Const. art. II, § 2, cl. 2; *see Lewis v. United States*, 458 F.3d 1372, 1377 (Fed. Cir. 2006) ("[T]he Constitution, statutes, and regulations can appropriately regulate the categories of persons who may be appointed to particular positions and the process by which those appointments are made. For example, Congress can restrain the President's authority to appoint particular classes of persons to officer positions or bar appointment unless particular procedures are followed.").

[32] *See Weiss v. United States*, 510 U.S. 163, 169–70 (1994); *Dysart v. United States*, 369 F.3d 1303, 1306 (Fed. Cir. 2004).

[33] *Cf. Jamerson v. United States*, 401 F.2d 808, 810 (Ct. Cl. 1968) (explaining that although reserve officer promotions are "By direction of the President," that language did not "reflect the President's personal participation").

[34] Exec. Order No. 13,384, 70 Fed. Reg. 43,739 (July 27, 2005); *see* 10 U.S.C. § 531(a)(1) ("Original appointments in [certain described officer grades] shall be made by the President alone."). The word *alone* in Section 531(a)(1) merely means that the "advice and consent" of the Senate is not

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commissioned officers are selected for promotion.[35] But the President has no involvement until the end of that process.[36] And the President has in any event delegated much of his responsibility.[37] Were Pruitt correct, the commission and promotion of nearly every officer who has ever served in the military would be invalid and the President would be required to spend nearly all of his time interviewing and selecting the thousands of officers who are appointed and promoted every year.

In light of the foregoing, it is apparent that the Appointments Clause does not bar Congress from limiting the pool of prospective appointees from which the Commission may appoint its administrative law judges and does not require the Commissioners to play any part in the selection of administrative law judges, other than the actual appointing.[38] The Commissioners may, as they determine appropriate, validly conduct any or no review of candidates they appoint as administrative law judges.

This brings us to Pruitt's claim that the Commission's ratification is ineffective absent the delivery of a commission.[39] In *Marbury v. Madison*, the Supreme Court explained that an appointment and a commission are two separate things.[40] While the latter is conclusive evidence of the former, it is not the exclusive evidence of the former.[41] Instead, "an appointment [may] be

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required for these appointments. *See Jamerson*, 401 F.2d at 810 (discussing similar language in what is now 10 U.S.C. § 12203).

35 *See* 10 U.S.C. §§ 611–26.

36 *See* 10 U.S.C. § 618(c)(1), (d)(1), (e)(1)(B).

37 Exec. Order No. 12,396, 47 Fed. Reg. 55,897 (Dec. 9, 1982).

38 *See Lewis*, 458 F.3d at 1377. Congress has limited agencies' discretion when making competitive service appointment decisions. *See* 5 U.S.C. § 3318(a). "Administrative law judge[s] … are in the competitive service." 5 C.F.R. § 930.201(b).

39 Mem. at 5–6.

40 5 U.S. at 156; *see Quackenbush v. United States*, 177 U.S. 20, 27 (1900) ("The appointment and the commission are distinct acts . . . .").

41 *Marbury*, 5 U.S. at 157.

evidenced by any public act, other than the commission."[42] And "the performance of such public act would create the officer."[43]

Here, the Commission's order ratifying the appointment of its administrative law judges is unquestionably a public, "open and unequivocal act."[44] The order was published on the Commission's website and is available through various electronic services, such as Westlaw or Lexis.[45] The Commission's intent to publicly announce its action is manifest. Given the public, unequivocal nature of the Commission's order, issuance of a separate commission is unnecessary.[46]

Tenure Protection

Pruitt asserts that the Solicitor General's decision in *Lucia* to ask the Supreme Court to address the constitutionality of the tenure protections enjoyed by the Commission's administrative law judges casts a constitutional pall over this proceeding sufficient to warrant staying it "pending the Supreme Court's review of the issue."[47]

Although the Solicitor General did ask the Court to address the tenure-protection issue in his response to the *Lucia* certiorari petition,[48] the

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[42] *Id*. at 156; *Nippon Steel Corp. v. U.S. Int'l Trade Comm'n*, 239 F. Supp. 2d. 1372–73 (Ct. Int'l Trade 2002); *see also Dysart*, 369 F.3d at 1311 ("[T]he granting of a commission is not always required for a Presidential appointment.").

[43] *Marbury*, 5 U.S. at 156; *see O'Shea v. United States*, 28 Ct. Cl. 392, 401 (1893) (holding that a letter from the Secretary of War informing O'Shea that the President had appointed him sufficed to evidence the appointment).

[44] *Nippon Steel*, 239 F. Supp. 2d. at 1372 ("an 'open and unequivocal act' on the part of an appointing authority … constitutes an act of appointment sufficient to create rights to an office").

[45] *See* https://www.sec.gov/litigation/opinions/2017/33-10440.pdf; 2017 WL 5969234; 2017 SEC LEXIS 3724.

[46] *See Laccetti,* 2016 WL 4582401, at *18 ("Courts have long relied on *Marbury* to conclude that the lack of a commission does not deprive an officer of the power of the office, and that an appointment is effective upon any 'open and unequivocal act.'").

[47] Mem. at 6–9; *see* Solicitor General's Brief at 18–21.

[48] Solicitor General's Brief at 18–21.

Court didn't take up that question.[49] Instead, it granted review of the question presented without specifying an additional issue. This suggests that tenure protection will not be addressed by the Court.[50] Pruitt is thus effectively seeking an indefinite stay, which is inappropriate.[51]

Moreover, the Commission has already rejected the same argument raised by other respondents.[52]

Pruitt's renewed motion to stay is DENIED.

Schedule

During a telephonic prehearing conference held last month, I asked the parties to confer about a proposed prehearing schedule, a proposed date to commence the hearing, and the anticipated length of the hearing. The parties have been unable to reach an agreement about when the hearing should begin. The Division proposes that the hearing should begin June 4, 2018;[53] Pruitt proposes October 15, 2018.[54]

Under Commission Rule of Practice 360(a)(2)(ii), I should schedule the hearing in this matter to begin no later than ten months after service of the order instituting proceedings (OIP).[55] Because the OIP was served on May 2,

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[49] *See* 2018 WL 386565 (granting review).

[50] *See Yee v. City of Escondido*, 503 U.S. 519, 535 (1992) ("under this Court's Rule 14.1(a), '[o]nly the questions set forth in the petition, or fairly included therein, will be considered by the Court.' While '[t]he statement of any question presented will be deemed to comprise every subsidiary question fairly included therein,' we ordinarily do not consider questions outside those presented in the petition for certiorari.").

[51] *See Richard Cannistraro*, Exchange Act Release No. 39521, 1998 WL 2614, at *1 (Jan. 7, 1998) (holding that under Rule 161, "any postponement must be for a definite period of time and cannot be open-ended").

[52] *See optionsXpress, Inc.,* Securities Act Release No. 10125, 2016 WL 4413227, at *50–52 (Aug. 18, 2016). I've rejected it, as well, and adhere to that determination. *Charles L. Hill, Jr.*, Admin. Proc. Rulings Release No. 2675, 2015 SEC LEXIS 1899, at *7–22 (ALJ May 14, 2015).

[53] Letter from David Oliwenstein at 1 (Feb. 2, 2018).

[54] Letter from Jimmy Fokas at 3 (Feb. 2, 2018).

[55] 17 C.F.R. § 201.360(a)(2)(ii).

2017, and after considering issues raised by the parties, I scheduled the hearing to begin February 20, 2018.[56] But I stayed the case after the parties informed me that they intended to settle and the Commission ratified my appointment and directed me to reconsider this record by February 16, 2018.[57] Both of these events tolled the deadlines in Rule 360(a)(2)(ii).[58]

Adding the three months of tolling to the ten months permitted under Rule 360 would ordinarily result in a hearing date in early June 2018. But as Pruitt notes, once the case was stayed, all "discovery and deposition dates were cancelled" and must now be rescheduled.[59] This means that "the parties cannot simply pick up where they left off almost three months ago" as if nothing happened in the interim.[60] At the same time, although Pruitt complains about the time needed to take six depositions, I am mindful that when he sought additional depositions he declared that granting him additional discovery would "in no way prejudice the Division or delay these proceedings."[61]

Balancing the foregoing, the fact that I am scheduled to hold a hearing beginning June 11, 2018, and the Independence Day holiday, which falls on a Wednesday this year, I order that the hearing will begin July 16, 2018. The parties are directed to confer and submit a proposed prehearing schedule.

James E. Grimes
Administrative Law Judge

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56 Prehearing Tr. 5–10; *David Pruitt, CPA*, Admin. Proc. Ruling Release No. 4842, 2017 SEC LEXIS 1602, at *3 (ALJ June 1, 2017).

57 *Pending Admin. Proc.*, 2017 WL 5969234, at *1; *David Pruitt, CPA*, Admin. Proc. Ruling Release No. 5229, 2017 SEC LEXIS 3596, at *3 (ALJ Nov. 15, 2017). The parties were not able to agree to settlement terms. *See David Pruitt, CPA*, Admin. Proc. Ruling Release No. 5362, 2017 SEC LEXIS 4030, at *3 (ALJ Dec. 11, 2017).

58 17 C.F.R. § 201.360(a)(2)(ii); *Pending Admin. Proc.*, 2017 WL 5969234, at *1.

59 Letter from Jimmy Fokas at 2.

60 *Id.*

61 Mem. in Support of Mot. to Depose Five Fact Witnesses and One Expert at 8 (Oct. 23, 2017).