UNITED STATES OF AMERICA

BEFORE THE

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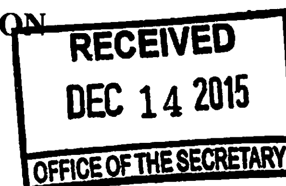
SECURITIES AND EXCHNAGE COMMISSION



ADMINISTRATIVE PROCEEDING

FILE NO. 3-15141

In the Matter of	)	
	)	
MOHAMMED RIAD AND KEVIN TIMOTHY SWANSON	))	REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS
	)	
Respondents.	)	

Dated: December 11, 2015

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Pursuant to Rules 154(a) and 411(d) of the Securities and Exchange Commission's ("SEC" or the "Commission") Rules of Practice, Respondents Mohammed Riad and Kevin Timothy Swanson (collectively, the "Respondents") hereby file this Reply Brief to the Brief of the Division of Enforcement ("Division") in opposition to the Respondents' petition to the Commission to dismiss this matter on the basis that:

1. This matter was tried before an Administrative Law Judge who was not properly appointed, in violation of the Appointments Clause of the United States Constitution, Article II, Section 2, clause.

2. Respondents were deprived of equal protection of the law, in contravention of the Fifth Amendment of the United States Constitution, because the Commission proceeded against them administratively rather than in federal district court.

I. The Administrative Law Judge Before Whom this Case Was Tried Was Not Properly Appointed

Shortly before Respondents filed their motion to dismiss, Federal District Court Judge May issued another decision on the Appointments Clause issue. *Ironridge Global IV, Ltd. v. SEC*, 1:15-CV-2512-LMM (N.D. Ga., Nov. 17, 2015). It that decision, Judge May amplified upon her previous analysis of the issue:

> The Court finds that like the STJs in Freytag, SEC ALJs exercise "significant authority." The office of an SEC ALJ is established by law, and the "duties, salary, and means of appointment for that office are specified by statute." *Id.*; see supra (setting out the ALJ system, to include the establishment of ALJs and their duties, salary, and means of appointment). ALJs are permanent employees—unlike special masters—and they take testimony, conduct trial, rule on the admissibility of evidence, and can issue sanctions, up to and including excluding people (including attorneys) from hearings and entering default. 17 C.F.R. §§ 200.14 (powers); 201.180 (sanctions).
>
> Relying on Landry v. Federal Deposit Insurance Corp., 204 F.3d 1125 (D.C. Cir. 2000), the SEC argues that unlike the STJs who were inferior officers in Freytag, SEC ALJs do not have contempt power and cannot issue final orders, as the STJs

could in limited circumstances. In Landry, the D.C. Circuit considered whether FDIC ALJs were inferior officers. The D.C. Circuit found FDIC ALJs, like the STJs, were established by law; their duties, salary, and means of appointment were specified by statute; and they conduct trials, take testimony, rule on evidence admissibility, and enforce discovery compliance. 204 F.3d at 1133-34. And it recognized that Freytag found that those powers constituted the exercise of "significant discretion . . . a magic phrase under the Buckley test." *Id.* at 1134

(internal citation omitted).

Despite the similarities of the STJs and the FDIC ALJs, the Landry court applied Freytag to hold that whether the entity had the authority to render a final decision was a dispositive factor. According to the D.C. Circuit, Freytag "noted that [(1)] STJs have the authority to render the final decision of the Tax Court in declaratory judgment proceedings and in certain small-amount tax cases," and (2) the "Tax Court was required to defer to the STJ's factual and credibility findings unless they were clearly erroneous." Landry, 204 F.3d at 1133 (emphasis in original). While recognizing that the Freytag court "introduced mention of the STJ's power to render final decisions with something of a shrug," Landry held that FDIC ALJ's were not inferior officers because did not have the "power of final decision in certain classes of cases." *Id.* at 1134.

The concurrence rejected the majority's reasoning, finding that Freytag "cannot be distinguished" because "[t]here are no relevant differences between the ALJ in this case and the [STJ] in Freytag." *Id.* at 1140, 1141. After first explaining that the Supreme Court actually found the Tax Court's deference to the STJ's credibility findings was irrelevant to its analysis, the concurrence stated that the majority's "first distinction of Freytag is thus no distinction at all." *Id.* at 1142. The concurrence also noted that the majority's holding in Landry (which ultimately relied on the FDIC ALJ's lack of final order authority) was based on an alternative holding from Freytag as the Supreme Court had already determined the STJs were inferior officers before it analyzed the final order authority issue. Landry, 204 F.3d at 1142.

The Landry decision is also not persuasive as FDIC ALJs differ from SEC ALJs in that their decisions are purely recommendary under the APA. The APA requires agencies to decide whether their ALJs will issue "initial decisions" or "recommendary decisions." Initial decisions may become final "without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule," while recommendary decisions always require further agency action. 5 U.S.C. § 557(b). FDIC ALJs issue recommendary decisions, whereas SEC ALJs issue initial decisions. On this ground alone, FDIC ALJs are different from SEC ALJs.

The Court concludes that the Supreme Court in Freytag found that the STJs powers—which are nearly identical to the SEC ALJs here—were independently sufficient to find that STJs were inferior officers. *See also* Butz v. Economou, 438

> U.S. 478, 513 (1978) ("There can be little doubt that the role of the . . . administrative law judge . . . is ' functionally comparable' to that of a judge. His powers are often, if not generally, comparable to those of a trial judge: He may issue subpoenas, rule on proffers of evidence, regulate the course of the hearing, and make or recommend decisions."); *see also* Freytag, 501 U.S. at 910 (Scalia, J., concurring in part and concurring in judgment, joined by O'Connor, Kennedy, & Souter, JJ.) (finding that all ALJs are "executive officers"); Edmond v. United States, 520 U.S. 651, 663 (1997) ("[W]e think it evident that 'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate."). Only after it concluded STJs were inferior officers did Freytag address the STJ's ability to issue a final order; the STJ's limited authority to issue final orders was only an additional reason, not the reason. Therefore, the Court finds that Freytag mandates a finding that the SEC ALJs exercise "significant authority" and are thus inferior officers.

In this decision, Judge May also directly addressed and rebutted arguments by the SEC relating to the Appointments Clause issue:

> At the Gray hearing, the SEC argued Freytag's finding that STJ's limited final order authority supported their inferior officer status was not an alternative holding but a "complimentary" one. The SEC also stated the Supreme Court's finding that the STJs had final order authority was the "most critical part" of the Freytag decision. The Court finds that understanding is based on a misreading of Freytag. First, the Supreme Court explicitly rejected the Government's argument in Freytag that "special trial judges may be deemed employees in subsection (b)(4) cases because they lack authority to enter a final decision." Freytag, 501 U.S. at 881. Second, the Supreme Court only discussed the STJs limited final order authority as being an additional reason for their inferior officer status. *Id.* at 882 ("Even if the duties of special trial judges under subsection (b)(4) were not as significant as we and the two courts have found them to be, our conclusion would be unchanged.") (emphasis added). It was only after the Supreme Court found STJs were inferior officers that it discussed their limited final order authority as being another ground for inferior officer status. The Court also does not find persuasive the SEC's argument that SEC ALJs are not inferior officers because they cannot issue "certain injunctive relief" as could the Special Trial Judges in Freytag. Def. Br., Dkt. No. [9] at 40. It is undisputed that the SEC Commissioners themselves—who are indisputably officers of the United States—cannot issue injunctive relief without going to the district court. Thus, the Court finds this a distinction without consequence.
>
> The SEC also argues that this Court should defer to Congress's apparent determination that ALJs are inferior officers. In the SEC's view, Congress is presumed to know about the Appointments Clause, and it decided to have ALJs appointed through OPM and subject to the civil service system; thus, Congress intended for ALJs to be employees according to the SEC. See Def. Br. [9] at 41-

45. But "[t]he Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint." Freytag, 501 U.S. at 880. Even if the SEC is correct that Congress determined that ALJs are inferior officers, Congress may not "decide" an ALJ is an employee, but then give him the powers of an inferior officer; that would defeat the separation-of-powers protections the Clause was enacted to protect.

In response to the SEC's argument that classifying ALJs as civil servants informs their constitutional status, the Court notes that competitive civil service by its terms also includes officers within its auspices. "Competitive [civil] service" includes with limited exceptions "all civil service positions in the executive branch," 5 U.S.C. § 2102, and "officers" are specifically included within competitive service. 5 U.S.C. § 2104. Thus, under the SEC's reasoning, all officers are now mere employees by virtue of Congress's placement of them in civil service. Such an argument cannot be accepted.

As well, the SEC argues that "Congress envisioned that an ALJ's 'initial decision' would be 'advisory in nature' and would merely 'sharpen[] . . . the issues for subsequent proceedings." Def. Br., Dkt. No. [9] at 36 (citing Attorney General's Manual on the Administrative Procedure Act ("Manual"), http://archive.law.fsu.edu/library/admin/1947vii.html, at 83-84 (1947)). But in reading the Manual, the Court finds the SEC has taken the Attorney General's statement out of context. With regard to ALJs "sharpening" "the issues for subsequent proceedings," the Attorney General was discussing cases in which the credibility of witnesses was not material or where the ALJ who drafted the opinion was not the hearing officer. Manual, at 83-84 ("However, in cases where the credibility of witnesses is not a material factor, or cases where the recommended or initial decision is made by an officer other than the one who heard the evidence, the function of such decision will be, rather, the sharpening of the issues for subsequent proceedings.") (emphasis added). The Manual also refers to ALJs as "subordinate officers" consistent with their status as inferior officers. *Id.* The Court finds the SEC's arguments unavailing; the SEC ALJs are inferior officers.

In the Division's Reply Brief, the Division dismisses the Respondent's arguments on the Appointments Clause issue and essentially refers the Commission to its prior decisions on this issue, without in any way addressing Respondents arguments or the opinions of Federal District Court Judges May and Berman. The only new argument on the Appointments Clause issue is raised in a footnote, where the Division argues that de novo review of the decisions of the Administrative Law Judges is meaningful. Two examples are provided - one in which the Commission reversed an Administrative Law Judge's finding of liability "because the Division

failed to establish his liability by a preponderance of evidence,"[1] and another in which the Commission reduced an accountant's suspension from practicing before the Commission from one year to six months.[2]

In fact, as Judge May correctly notes, for purposes of the Appointments Clause analysis, the relevant question is whether the Administrative Law Judge's Initial Decision is purely recommendary. Where that is not the case, since de novo review of questions of law always applies for appellate courts,[3] such de novo review is not relevant to the Appointments Clause analysis. If de novo review on appeal was sufficient to make trial judges mere employees, then all federal district court judges would be employees and not subject to the Appointments Clause, which is obviously not the case.

The examples offered by the Division are also singularly unpersuasive. First, only two examples are offered. Second, the actions taken by the Commission – finding that no reasonable fact finder could find liability and that a suspension should be reduced – are typical of decisions

[1] In re Pelosi, Admin. Proc. 3-14194 (Mar. 27, 2014).

[2] In re Wendy McNeeley, Admin. Proc. 3-13797 (Dec. 12, 2012).

[3] The Supreme Court has explained why de novo review of questions of law is always available on appeal: "District judges preside alone over fast-paced trials: Of necessity they devote much of their energy and resources to hearing witnesses and reviewing evidence. Similarly, the logistical burdens of trial advocacy limit the extent to which trial counsel is able to supplement the district judge's legal research with memoranda and briefs. Thus, trial judges often must resolve complicated legal questions without benefit of extended reflection or extensive information. … Courts of appeals, on the other hand, are structurally suited to the collaborative juridical process that promotes decisional accuracy. With the record having been constructed below and settled for purposes of the appeal, appellate judges are able to devote their primary attention to legal issues" *Salve Regina College v. Russell*, 499 U.S. 225, 231–32 (1991) (internal quotation marks deleted). In other words, just as the trial court has a unique institutional role in resolving factual disputes, an appellate court has the institutional role of resolving legal questions. Because of these different roles, an appellate court will review a trial court's interpretation of the law de novo.

by appellate courts. These actions hardy demonstrate that the decisions of Administrative Law Judges are merely recommendary. Moreover, the Division's Reply Brief simply ignores Respondents' argument that the Commission defers to the Administrative Law Judges on questions of the credibility of witnesses, the admissibility of evidence, and the admissibility of expert testimony and reports, which means that de novo review effectively does not apply to these determinations by the Administrative Law Judges.

II. The Institution of this Action as an Administrative Proceeding Violated the Equal Protection Clause

The Division's Reply Brief wholly ignores Judge Rakoff's penetrating analysis of this issue, instead relying on three new arguments. First, the Division argues that *Engquist v. Oregon Department of Agriculture*, 553 U.S. 591 (2008), stands for the position that a "subjective, individualized decision" such as the selection of the administrative forum instead of federal district court cannot be challenged on equal protection grounds. Second, the Division argues that the Respondents have not proven either that their case was large and complex or that large and complex cases are almost never litigated in the administrative forum. Third, the Division argues that there is a legitimate reason for the selection of the administrative forum in this case, the need for speed in imposing an associational bar.

The first reason misinterprets the Engquist decision. That decision sets forth the same standard the Respondents, and Judge Rakoff, impose on the Commission's selection of the administrative forum:

> When those who appear similarly situated are nevertheless treated differently, the Equal Protection Clause requires at least a rational reason for the difference, to assure that all persons subject to legislation or regulation are indeed being "treated alike, under like circumstances and conditions." Thus, when it appears that an individual is being singled out by the government, the specter of arbitrary classification is fairly raised, and the Equal Protection Clause requires a "rational basis for the difference in treatment." Olech, 528 U.S., at 564, 120 S.Ct. 1073.

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Although the plaintiff did not prevail in Engquist, the Court's express reason for its holding was a policy consideration, "unique considerations applicable when the government acts as employer as opposed to sovereign":

> In concluding that the class-of-one theory of equal protection has no application in the public employment context—and that is all we decide—we are guided, as in the past, by the "common-sense realization that government offices could not function if every employment decision became a constitutional matter. . . . In short, ratifying a class-of-one theory of equal protection in the context of public employment would impermissibly 'constitutionalize the employee grievance.'

Here, the application of the Equal Protection standard is especially appropriate because the alleged unequal treatment – being forced to litigate a large and complex case with extraordinary speed – deprived the Respondents of another Constitutional right, the right to adequate time to prepare for trial and to consult with counsel in that process. In this regard, it is telling that the Engquist decision discusses whether the police can Constitutionally chose to prosecute only a few speeders rather than all of them and concludes that such selective prosecution is permissible. But it most certainly does not follow from this observation that the police could Constitutionally elect to offer only some persons arrested for speeding the right to a fair trial.

As for the Division's second argument, the Division offers no evidence of its own on the question of whether this case is unusually large and complex and whether large and complex cases are almost never tried in the administrative forum, where immovable and unreasonable deadlines preclude proper preparation of large and complex cases for trial. On this issue, the Motion Requesting Extension of Time to File Initial Decision speaks for itself: "It will not be possible to issue an Initial Decision within the time specified due to the size and complexity of the proceeding . . . . The hearing occurred over eleven days and produced over 3,600 pages of transcript. The parties presented testimony from seventeen lay witnesses and three expert

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witnesses, and 352 exhibits were admitted into evidence."[4] It is also telling that this matter remains unresolved over seven years after the underlying conduct at issue ended, further confirming the size and complexity of this case.

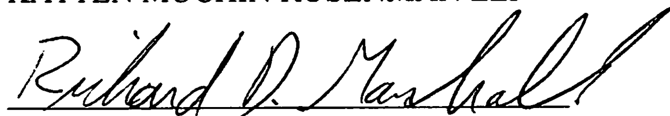
As for the supposed "legitimate reason" for selecting the administrative forum - the need for speed in imposing an associational bar - this so-called legitimate reason rings hollow. No associational bar of any kind has been imposed on the Respondents to this day, over seven years after the conduct in question ended. On this record, it is simply not credible that the need for speed was the real reason underlying the Commission's selection of the administrative forum.

Conclusion

For the foregoing reasons and those set forth in Respondents' opening brief, Respondents respectfully urge the Commission to dismiss this action.

December 11, 2015

Respectfully submitted,
KATTEN MUCHIN ROSENMAN LLP



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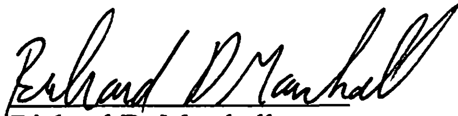
[4] Sept. 16, 2013, available at http://www.sec.gov/alj/aljorders/2013/ap-875.pdf.

CERTIFICATE OF COMPLIANCE WITH RULE 450(d)

I, Richard Marshall, certify that this brief complies with the word limitation set forth in Commission Rule of Practice 450(c), as it contains 2,914 words, excluding the parts of the brief exempted by the Rule.[1]



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[1] 1 17 C.F.R. §201.450 (c).

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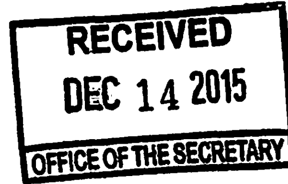
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15141



In the Matter of

MOHAMMED RIAD AND KEVIN TIMOTHY SWANSON

Respondents.

CERTIFICATE OF SERVICE

Richard D. Marshall, an attorney, certifies that on December 11, 2015, he caused true and correct copies of Respondents' Reply Brief in Support of Motion to Dismiss to be served by mail on the following:

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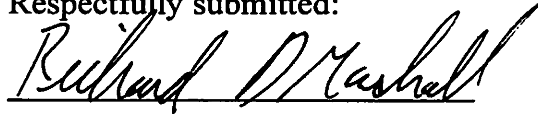

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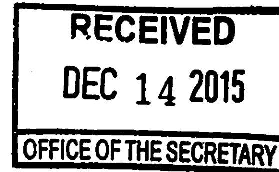

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Re: In the Matter of Mohammed Riad and Kevin Timothy Swanson, File No. 3-15141

Dear Mr. Fields

Enclosed please find the original and three copies of the Reply Brief in Support of Motion to Dismiss and Certificate of Service for filing with the Securities and Exchange Commission in the above-captioned matter.

Very truly yours,

Richard D. Marshall

RDM: