UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15168

In the Matter of	
JOHN J. AESOPH, CPA, and DARREN M. BENNETT, CPA	
Respondents.	

RESPONDENTS' JOINT SUPPLEMENTAL BRIEF IN SUPPORT OF APPEAL

October 21, 2015

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Respondents John J. Aesoph and Darren M. Bennett respectfully submit this supplemental brief on the issue of whether "the Commission's administrative law judges ["ALJs"] are 'inferior officers' within the meaning of the Appointments Clause, and whether their manner of appointment violates the Appointments Clause." *See* Order Granting Motion to Submit Supplemental Briefing (Oct. 7, 2015).

INTRODUCTION

In her decision dated June 27, 2014, Administrative Law Judge Carol Fox Foelak ("ALJ Foelak") denied Mr. Aesoph and Mr. Bennett the privilege of appearing and practicing before the Securities and Exchange Commission ("Commission" or "SEC") as an accountant for one year and for six months, respectively. Those determinations were the culmination of a nearly eighteen-month administrative proceeding over which ALJ Foelak presided. In that role, ALJ Foelak (i) resolved procedural and substantive motions addressing, among other issues, interpretation of audit and accounting rules and standards and the Division's conduct of the investigation, (ii) presided over a nine-day evidentiary hearing that generated in excess of 2,300 pages of transcript, (iii) made hundreds of rulings as to the admissibility of lay and expert testimony and exhibits presented at the hearing, and (iv) made credibility determinations regarding the testimony of certain of the witnesses who appeared at the hearing. After requesting and considering post-hearing submissions, ALJ Foelak then issued a 39-page Initial Decision in which she made hundreds of findings of fact and conclusions of law.

The Appointments Clause of the Constitution requires that officers exercising significant power be appointed pursuant to certain procedural safeguards. *See* U.S. CONST. Art. II, § 2, cl. 2; *Freytag v. Comm'r of Internal Revenue,* 501 U.S. 868, 881 (1991) ("'[A]ny appointee exercising significant authority pursuant to the laws of the United States is an "Officer of the United

States," and must, therefore, be appointed in the manner prescribed by § 2, cl. 2, of [Art. II].'" (quoting *Buckley v. Valeo*, 424 U.S. 1, 126 (1976))).

ALJ Foelak was not appointed pursuant to the process set forth in the Appointments Clause, even though she exercised substantial discretionary authority over the administrative proceeding in this case. As a result, Messrs. Aesoph and Bennett were denied the procedural protections guaranteed by Constitution for the appointment of ALJ Foelak. That unconstitutional administrative process resulted in an Initial Decision that deprives Respondents of the ability to engage in "a way of life to which [they] ha[ve] devoted years of preparation and on which [they] and [their] famil[ies] have come to rely." *Checkosky v. SEC*, 23 F.3d 452, 479 (D.C. Cir. 1994) (internal quotation marks omitted) (per curiam).

Because the proceeding adjudicated by ALJ Foelak violated the Appointments Clause, the underlying judgment must be vacated. Further, given the countless discretionary and non-discretionary decisions made by ALJ Foelak, the Commission cannot remedy the constitutional violation by reviewing an administrative record that itself was irrevocably tainted by that unconstitutional process.

BACKGROUND

The Commission is authorized by law to appoint ALJs and to delegate to them "any of its functions." *See* 5 U.S.C. § 3105; 15 U.S.C. § 78d-1(a). SEC ALJs are empowered to "conduct[] hearings in proceedings instituted by the Commission," 17 C.F.R. § 200.14(a), and the Commission can delegate it own core authority to preside over particular administrative proceedings to its ALJs. In such cases, a presiding ALJ is selected by the Chief ALJ. 17 C.F.R. § 201.110. The designated ALJ is responsible for the "fair and orderly conduct" of the proceeding, from the pre-hearing conference through the issuance of the Initial Decision, and has

a broad mandate to regulate "the course of [the] proceeding and the conduct of the parties and their counsel." *See* 17 C.F.R. § 200.14; 5 U.S.C. § 556(c); SEC Rule of Practice ("ROP") 111. [1]

Perhaps the most significant authority delegated to ALJs is the responsibility to issue a post-hearing "Initial Decision" that includes "factual findings, legal conclusions, and, where appropriate, orders" including "sanctions" that may suspend or revoke the industry registrations of individuals and entities, "disgorg[e] ill-gotten gains," impose civil penalties, censures, and cease and desist orders, and suspend or bar persons from association with industry entities. *See* SEC, *Office of Administrative Law Judges, available at* www.sec.gov/alj; 17 C.F.R. § 201.360(a)(1), (b) ("An initial decision shall include: Findings and conclusions, and the reasons or basis therefor, as to all the material issues of fact, law or discretion presented on the record and the appropriate order, sanction, relief, or denial thereof.").

Unless the Commission reviews the ALJ's Initial Decision *sua sponte* or on a petition for review filed by a party, the ALJ's Initial Decision is "for all purposes, including appeal or review thereof, []deemed the action of the Commission." 15 U.S.C. § 78d-1; 17 C.F.R. § 201.360(b)(1). The Commission's review of the ALJ's Initial Decision is "limited to the issues specified in the petition for review" and any additional issues that the Commission specifies in the briefing

[1]The SEC's own definition of the functions of its ALJs highlights their extensive authority: "[ALJs] conduct a public administrative proceeding to determine whether the allegations in the [Order Instituting Proceedings] are true and to issue an Initial Decision. . . . [ALJs] are independent judicial officers who in most cases conduct hearings and rule on allegations of securities law violations initiated by the Commission's Division of Enforcement. They conduct public hearings . . . in a manner similar to non-jury trials in the federal district courts." SEC, *Office of Administrative Law Judges, available at* www.sec.gov/alj. Specific examples of this broad authority include the power to: preside over prehearing conferences; issue, revoke, quash, and/or modify subpoenas; rule on the admissibility of evidence and offers of proof; order production of evidence; order depositions and act as the "deposition officer"; order prehearing submissions; issue orders, including show-cause orders; take testimony; regulate the scope of cross-examination; dismiss a case, decide a matter against a party, or prohibit introduction of evidence for failure to meet deadlines or cure a deficient filing; impose sanctions for contemptuous conduct; enter orders of default; take "official notice" of facts not appearing in the record; certify issues for interlocutory review and determine whether proceedings should be stayed during the pendency of such review; and rule on requests and motions, including dispositive motions. 5 U.S.C. § 556(c); 17 C.F.R. §§ 200.14, 200.30-9; 201.111, 201.141(b); ROP 111, 155, 180, 221(b), 222(a), 230, 232-34, 250(b), 320, 323, 326, 400(c)-(d).

schedule order or determines to raise thereafter. 17 C.F.R. § 201.411(d). Further, the Commission accepts the ALJ's "credibility finding, absent overwhelming evidence to the contrary." *In re Clawson*, Exchange Act Release No. 48143, 2003 WL 21539920, at *2 (July 9, 2003); 17 C.F.R. §§ 201.411(a), 201.460.

ARGUMENT

The Supreme Court has long recognized that the Appointments Clause is "more than a matter of 'etiquette or protocol'; it is among the significant structural safeguards of the constitutional scheme." *Edmond v. United States*, 520 U.S. 651, 659 (1997) (quoting *Buckley*, 424 U.S. at 125). As explained by the Supreme Court in *Freytag*:

> The Appointments Clause not only guards against [the encroachment of separation of powers] but also preserves another aspect of the Constitution's structural integrity by preventing the diffusion of the appointment power. . . . The Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint. . . . [T]he Clause forbids Congress to grant the appointment power to inappropriate members of the Executive Branch. Neither Congress nor the Executive can agree to waive this structural protection. . . . The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic.

501 U.S. at 878-80. The Appointments Clause guarantees that those exercising "significant authority pursuant to the laws of the United States," *id.* at 881, have been vetted by the President, the courts of law, or the heads of a department, and that these "eligible recipients of the power to appoint" have deemed the officers worthy of upholding the laws on the basis of their qualifications, impartiality, and commitment to abide by the Constitution. *Id.* at 880.

This system of accountability is particularly important where, as here, the ALJ wields authority in a proceeding that affects respondents' very livelihood. It is wholly inconsistent with the Appointments Clause requirement of accountability to subject respondents in these

circumstances to the whim and judgment of mere employees in "the most basic category within the civil service; [which] includes positions such as corrections officers, human resources specialists, and paralegals." Div. of Enforcement's Mem. of Law in Resp. to Comm'n Order Req. Supp. Br. at 2, *In re Timbervest, LLC, et al.*, Investment Advisors Act Release No. 4197 (Sept. 17, 2015) (citing 5 U.S.C. § 2102; 5 C.F.R. § 212.101). The Supreme Court's analysis in *Freytag* compels the conclusion that the Commission's ALJs are inferior officers subject to the Appointments Clause, and the violation of this structural guarantee has subjected Respondents to an unconstitutional proceeding entirely lacking in the accountability ensured by the Appointments Clause.

I. SEC ALJS ARE "INFERIOR OFFICERS" WITHIN THE MEANING OF THE APPOINTMENTS CLAUSE.

The Appointments Clause governs the appointment of "Officers of the United States" and divides such officers into two categories: "principal officers," who must be appointed by the President and confirmed by the Senate, and "inferior officers," who must be appointed by the President, the "Courts of Law," or the "Heads of Departments." *See* U.S. CONST. Art. II, § 2, cl. 2; *see also United States v. Germaine*, 99 U.S. 508, 509-10 (1878); *Edmond*, 520 U.S. at 662. Government employees, who are not "Officers of the United States," need not be appointed in accordance with the Appointments Clause. *See Freytag*, 501 U.S. at 880. The Supreme Court has provided specific guidance to distinguish between "Officers of the United States" and "mere employees,": "[a]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States' and must, therefore, be appointed in the manner prescribed by" the Appointments Clause. *Buckley v. Valeo*, 424 U.S. 1, 126 (1976); *see also Freytag*, 501 U.S. at 881.

A. SEC ALJs Exercise Significant Authority Pursuant to the Laws of the United States.

Considering the extensive discretion afforded to SEC ALJs in carrying out their broad mandate to "conduct[] hearings in proceedings instituted by the Commission," 17 C.F.R. § 200.14(a), the authority that they exercise is "significant" under the Supreme Court's controlling precedent. The Supreme Court has held that various categories of government employees, many of whom hold significantly *less* authority than SEC ALJs, are "inferior officers" rather than "mere employees." Examples include "district-court clerks, thousands of clerks within the Treasury and Interior Departments, an assistant surgeon, a cadet-engineer, election monitors, federal marshals, military judges, Article I [Tax Court special trial] judges, and the general counsel for the Transportation Department." Kent Barnett, *Resolving the ALJ Quandry*, 66 VAND. L. REV. 797, 812 (2013); *see also Edmond*, 520 U.S. at 661.

Precedent from the United States Supreme Court and lower federal courts compels the same conclusion with regard to SEC ALJs. In *Freytag*, the Supreme Court held that a category of adjudicators analogous to SEC ALJs—U.S. Tax Court Special Trial Judges—are inferior officers under the Appointments Clause. 501 U.S. at 880-82. In addition, Justices Scalia and Breyer have addressed the status of ALJs under the Appointments Clause in separate opinions, both concluding that "administrative law judges . . . are all executive officers." *Freytag*, 501 U.S. at 910 (Scalia, J., concurring in part and concurring in the judgment) (emphasis omitted); *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 542 (2010) (same) (Breyer, J., dissenting).

In *Freytag*, the Supreme Court applied the "significant authority" rule, holding that Special Trial Judges ("STJs") exercise "significant authority pursuant to the laws of the United States" because, among other reasons, the office of STJ is "established by law"; "the duties, salary, and means of appointment for that office are specified by statute"; they perform "more

than ministerial" tasks in carrying out their adjudicative authority including taking testimony, conducting trials, ruling on the admissibility of evidence, and enforcing compliance with discovery orders; and they exercise "significant discretion" in carrying out these functions. 501 U.S. at 880-82.

More recently, federal district courts in the Southern District of New York and the Northern District of Georgia have addressed the status of SEC ALJs under the Appointments Clause. After determining that *Freytag* controls, these courts have concluded that SEC ALJs likely qualify as inferior officers subject to the Appointments Clause. *See Duka v. SEC*, No. 15-cv-357, 2015 WL 4940083, at *2-3 (S.D.N.Y. Aug. 12, 2015) (Berman, J.); *Gray Fin. Grp. v. SEC*, No. 15-cv-492, slip op. at 26-36 (N.D. Ga. Aug. 4, 2015) (May, J.); *Hill v. SEC*, No. 15-cv-1801, 2015 WL 4307088, at *16-19 (N.D. Ga. June 8, 2015) (May, J.). In all three cases, the courts preliminarily enjoined ongoing SEC administrative proceedings because Plaintiffs' arguments that the ALJs assigned to preside over the SEC's administrative proceedings against them are inferior officers whose appointments are unconstitutional under the Appointments Clause were likely to succeed on the merits.

Judge May observed in *Gray* 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.'" *Gray*, slip op. at 29 (quoting *Freytag*, 501 U.S. at 881-82); *Hill*, 2015 WL 4307088, at *17; *Duka v. SEC*, No. 15-cv-357, 2015 WL 4940057, at *2 (Aug. 3, 2015); *see also* 5 U.S.C. § 3105; 5 U.S.C. § 5372. Judge May continued: "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." *Gray*, slip op. at 29;

17 C.F.R. §§ 200.14, 201.180.[2] Further, like STJs, SEC ALJs exercise "significant discretion" in carrying out these functions. Indeed, SEC ALJs exercise their full discretion in making each judgment throughout the adjudicative process, from evidentiary decisions, to credibility determinations that the Commission accepts "absent overwhelming evidence to the contrary" to, ultimately, the Initial Decision and each factual finding, legal conclusion, and sanction included therein. *See Clawson*, 2003 WL 21539920, at *2; 17 C.F.R. § 201.360(a)(1), (b).

Because the "STJs powers" on which the Supreme Court relied in holding that they were inferior officers in *Freytag* are "nearly identical to the SEC ALJs here," "*Freytag* mandates a finding that the SEC ALJs exercise 'significant authority' and are thus inferior officers." *Gray*, slip op. at 32-33; *see also Hill*, 2015 WL 4307088, at *16-18 ("based upon the Supreme Court's holding in *Freytag*, SEC ALJs are inferior officers"); *Duka*, 2015 WL 4940057, at *2 ("SEC ALJs are 'inferior officers' because they exercise 'significant authority pursuant to the laws of the United States'" (citing *Freytag*, 501 U.S. at 881)).[3]

B. The Commission's Opinions Concluding that SEC ALJs Are "Mere Employees" Misapply Controlling Supreme Court Authority.

The Commission recently has held that SEC ALJs are *not* inferior officers and are therefore not subject to the requirements of the Appointments Clause. *See In re Lucia Co. & Lucia, Sr.*, Exchange Act Release No. 75837 at 3, 28-33 (Sept. 3, 2015); *In re Timbervest et al.*,

[2] As the Supreme Court has noted, the authority exercised by an ALJ is "functionally 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." *Butz v. Economou*, 438 U.S. 478, 513 (1978).

[3] The Department of Justice's Office of Legal Counsel also provides helpful guidance regarding the scope of the category of inferior officers: "a position, however labeled, is in fact a federal office [subject to the Appointments Clause] if (1) it is invested by legal authority with a portion of the sovereign powers of the federal Government, and (2) it is 'continuing.'" Memorandum Opinion for the General Counsels of the Executive Branch, *Officers of the United States Within the Meaning of the Appointments Clause*, *available at* http://www.justice.gov/sites/default/files/olc/opinions/2007/04/31/appointmentsclausev10.pdf (Apr. 16, 2007). SEC ALJs are (1) vested with the authority delegated by the Commission to "conduct[] hearings in proceedings instituted by the Commission," 17 C.F.R. § 200.14(a), and (2) appointed for their careers and removable only for good cause. 5 C.F.R. § 930.204; 5 U.S.C. § 7521.

Investment Advisers Act Release No. 4197, slip op. at 2, 41-46 (Sept. 17, 2015). These opinions do not resolve this issue, as they rely on precedent that misapplies the Supreme Court's "significant authority" rule described above.

In *Landry v. FDIC*, the D.C. Circuit held that FDIC ALJs are not inferior officers under the Appointments Clause. 204 F.3d 1125, 1134 (D.C. Cir. 2000). The D.C. Circuit addressed the adjudicator's power to issue final decisions on behalf of the agency, noting that it is "uncertain just what role the STJs' power to make final decisions played in *Freytag*" and that "the [*Freytag*] court introduced mention of the STJs' power to render final decisions with something of a shrug." *Id.* at 1133-34. Nevertheless, the D.C. Circuit opined that "the STJs' power of final decision . . . was critical to the [*Freytag*] Court's decision" and determined that FDIC ALJs are not inferior officers because they issue only "recommended decisions." *Id.*

In holding that SEC ALJs are not inferior officers, the Commission relied upon *Landry*'s conclusion that the "touchstone for determining whether adjudicators are inferior officers is the extent to which they have the power to issue 'final decisions.'" *See Lucia*, slip op. at 29; *Timbervest*, slip op. at 41. But that reasoning ignores that *Freytag* addressed the STJ's authority to issue final decisions only *after* it already had held that STJs are inferior officers, and discussed the issue only as an alternative holding, finding that even though STJs may not render final decisions in all circumstances, the Court's conclusion that they are inferior officers was "unchanged." 501 U.S. at 881. The *Freytag* Court criticized the government's argument that STJs are "mere employees" because they "lack authority to enter a final decision," holding that it "ignore[d] the significance of the duties and discretion that [STJs] possess." 501 U.S. at 881. *Freytag* also cited favorably, *id.*, the decision in *Samuels, Kramer & Co. v. Commissioner of Internal Revenue*, 930 F.2d 975 (2d Cir. 1991), where the Second Circuit rejected the argument

that STJs must have the authority to issue final decisions to be considered inferior officers. *Samuels*, 930 F.2d at 985-86 ("Although the ultimate decisional authority . . . rests with the Tax Court judges, [STJs] . . . exercise a great deal of discretion and perform important functions, characteristics that we find to be inconsistent with the classifications of 'lesser functionary' or mere employee."). Like the STJs in *Freytag* and *Samuels*, the SEC ALJs' exercise of significant authority and discretion confirms that they are inferior officers.

The district courts in *Gray*, *Hill*, and *Duka* also rejected *Landry*'s emphasis on the authority to issue final decisions as a "misreading of *Freytag*." *Gray*, slip op. at 29-33 ("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." (emphasis in original)); *Hill*, 2015 WL 4307088, at *17-18 (same); *Duka*, 2015 WL 4940057, at *2 (citing *Freytag* and noting that *Landry* "is to the contrary").[4]

The Commission's efforts to distinguish *Freytag* and draw analogies to *Landry* are unavailing. *See Lucia*, slip op. at 32-33; *Timbervest*, slip op. at 44-46. For the reasons discussed *supra*, the *Landry* Court's conclusion that FDIC ALJs are not inferior officers is flawed, and a proper application of the Supreme Court's "significant authority" rule would yield a different result than in *Landry*.[5]

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[4] *Landry*'s proposition that final decision-making authority is a necessary power of inferior officers also conflicts with Supreme Court precedent under which final decision-making authority is a factor that distinguishes *inferior* officers from *principal* officers. *See Edmond*, 520 U.S. at 665-66 (holding that Coast Guard Court of Criminal Appeals judges are "inferior officers" rather than "principal officers" in part because they "have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers"). Indeed, the government argued in *Free Enterprise* that PCAOB Board Members are inferior officers rather than principal officers because, among other reasons, "unlike SEC Commissioners" they "have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive Officers." *See* Brief of the United States at *31-32 & n.10, *Free Enterprise*, 561 U.S. 477, 2009 WL 3290435.

[5] The Commission also relies on an alleged Congressional intent to classify SEC ALJs as "mere employees" rather than inferior officers. *See Lucia, slip op.* at 33 n.121. Even assuming that Congress did intend that ALJs not be classified as inferior officers under the Appointments Clause, a conclusion not supported by the statutory provisions

Even if *Landry*'s emphasis on the power to issue final decisions were not erroneous, the Supreme Court's decision in *Freytag* still controls because *Freytag* is not distinguishable. The Commission attempts to distinguish *Freytag* by arguing that the Tax Court must defer to certain factual findings made by the STJs unless "clearly erroneous," whereas, under *Landry*, the FDIC Board makes its own factual findings. *See Lucia*, slip op. at 32; *Timbervest*, slip op. at 45. Of course, the Commission defers to SEC ALJs' credibility determinations "absent overwhelming evidence to the contrary," *see Clawson*, 2003 WL 21539920, at *2, but even so, the Supreme Court in *Freytag* specifically noted that the Tax Court rule requiring deference to STJs' factual findings was "not relevant to [its] grant of certiorari." *Freytag*, 501 U.S. at 874 n.3; *Gray*, slip op. at 31 n.9; *Hill*, 2015 WL 4307088, at *18 n.11.[6]

The Commission's attempt to distinguish *Freytag* (and follow *Landry*) based on the ability of STJs to issue final decisions on behalf of the Tax Court should also be reconsidered. *Lucia*, slip op. at 33; *Timbervest*, slip op. at 45. Even if *Landry*'s emphasis on this issue were appropriate, this point actually *distinguishes* the FDIC ALJs in *Landry* from SEC ALJs. As Judge May explained in *Gray*, "[t]he APA requires agencies to decide whether their ALJs will

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cited by the Commission, *see id.*; *Timbervest*, slip op. at 46 n.166, "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 [Appointments] Clause was enacted to protect." *Gray*, slip op. at 34-35.

[6] The Commission also points to STJs' powers to punish contemptuous conduct by fine or imprisonment and enforce subpoenas in its effort to distinguish *Freytag*. *Lucia, slip op.* at 33; *Timbervest*, slip op. at 45. The Commission's Rules also provide ALJs with authority to punish contemptuous conduct. *See* 17 C.F.R. § 201.180. The difference on which the Commission rests this point is the *manner* of punishment—the forms of punishment for contemptuous conduct available to SEC ALJs include excluding persons from hearings or conferences and summarily suspending persons from representing others in the proceeding. *Id.* Nothing in any of the Supreme Court's relevant authorities, or indeed in *Landry*, suggests that the scope of "significant authority under the laws of the United States" should be defined so arbitrarily. With regard to the lack of authority to compel compliance with subpoenas, as the Commission points out, "the Commission itself would need to seek an order from a federal district court to compel compliance" with a subpoena. *Timbervest*, slip op. at 45 (citing 15 U.S.C. § 78u(c)). If this does not compromise the undisputed "officer" status of the Commissioners themselves, it likewise cannot render SEC ALJs "mere employees." *See Gray*, slip op. at 33-34 (noting, similarly, that SEC ALJs' lack of ability to issue certain injunctive relief is "without consequence" because "the *SEC Commissioners* themselves—who are indisputably officers of the United States," also lack that authority).

issue 'initial decisions,'" which "may become final 'without further proceedings'" and "recommended decisions" which "always require further agency action." *Gray*, slip op. at 31-32 (quoting 5 U.S.C. § 557(b)). "The *Landry* decision is []not persuasive as FDIC ALJs differ from SEC ALJs" in that they issue "recommended decisions" whereas SEC ALJs issue "initial decisions." *Gray*, slip op. at 31-32. Unless the Commission reviews an ALJ's Initial Decision on its own initiative or by granting a Petition for Review filed by a party, the ALJ's Initial Decision "shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. § 78d-1; *see also* 5 U.S.C. § 557; ROP 360(d)(2). In many proceedings, including the instant case, review by the Commission is not mandatory or automatic; it is at the Commission's discretion—"[t]he Commission may decline to review" the ALJ's Initial Decision, and the rules set forth criteria to be considered by the Commission in exercising that discretion. *See* ROP 411; 17 C.F.R. § 201.411(b)(2).

The Commission seeks to minimize the distinction between "recommended" and "initial" decisions under the APA by asserting its "longstanding practice to grant virtually all petitions for review." *See Lucia*, slip op. at 30; *Timbervest*, slip op. at 44. The reality is that where the parties choose not to file a petition for review, and the Commission does not review on its own initiative, the ALJ's Initial Decision is "deemed the action of the Commission." *See* 15 U.S.C. § 78d-1.[7] In such cases, the Commission's sole role is to issue the order formalizing the finality

[7] For example, in September 2015 alone, ALJ Initial Decisions became the final decision of the Commission in fourteen administrative proceedings. *See In re Sino Clean Energy, Inc.*, Exchange Act Release No. 75797 (Sept. 1, 2015); *In re Guardian Zone Tech., Inc., et al.*, Exchange Act Release No. 75798 (Sept. 1, 2015); *In re Enterologics, Inc., et al.*, Exchange Act Release No. 75799 (Sept. 1, 2015); *In re Flying Eagle PU Tech. Corp.*, Exchange Act Release No. 75808 (Sept. 2, 2015); *In re Accres Holding, Inc., et al.*, Exchange Act Release No. 75869 (Sept. 10, 2015); *In re Baxter Capital Co., et al.*, Exchange Act Release No. 75870 (Sept. 10, 2015); *In re Anthl, Inc., et al.*, Exchange Act Release No. 75871 (Sept. 10, 2015); *In re Hinds, Inc. & Kenyon, Inc.*, Exchange Act Release No. 75872 (Sept. 10, 2015); *In re GSP-2, Inc.*, Exchange Act Release No. 75873 (Sept. 10, 2015); *In re Vantone Int'l Grp., Inc.*, Exchange Act Release No. 75909 (Sept. 14, 2015); *In re Horizon Wimba, Inc. & Interlock Servs., Inc.*, Exchange Act Release No. 75929 (Sept. 16, 2015); *In re KPNQWEST N.V. & Preventia, Inc.*, Exchange Act.

of the ALJ's Initial Decision. Further, even where the Commission does review the Initial Decision, its opinion generally incorporates the ALJ's credibility findings. *See Clawson*, 2003 WL 21539920, at *2.[8]

II. ALJ FOELAK'S APPOINTMENT VIOLATES THE APPOINTMENTS CLAUSE.

It is undisputed that ALJ Foelak was not appointed in accordance with the Appointment Clause's requirements for inferior officers. *See* Transcript of Hearing at 25-26, *Tilton v. SEC*, No. 15-cv-2472 (S.D.N.Y. May 11, 2015) ("we acknowledge that the commissioners were not the ones who appointed, in this case, ALJ [Foelak]"). The Division cannot deny that, in this matter, ALJ Foelak made numerous important determinations, including interpretations of complex audit and accounting standards. As set forth in Respondents' Opening and Reply Briefs, many of ALJ Foelak's decisions were based on, among other things, erroneous interpretations of law, a failure to adequately consider supporting and contradicting evidence, and a refusal properly to consider and weigh expert testimony. Yet these decisions are afforded significant weight and deference on review. *Clawson*, 2003 WL 21539920, at *2. The sheer power wielded by the ALJ here stands in stark contrast to the manner in which she was appointed—not by the President, a Court of Law, or the Head of a Department, but rather, by the U.S. Office for Personnel Management, which "oversees federal employment for ALJs as it does for other rank-and-file civil servants." Div. of Enforcement's Mem. of Law in Resp. to Comm'n

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Release No. 75957 (Sept. 22, 2015); *In re Aspire Japan, Inc. et al.*, Exchange Act Release No. 75972 (Sept. 24, 2015); *In re Capital Connection, Inc., et al.*, Exchange Act Release No. 76004 (Sept. 29, 2015).

[8] Moreover, beyond the technicalities of "finality" under the APA, Initial Decisions issued by SEC ALJs are immediately published on the SEC's website, prior to any opportunity for Commission review. *See* ROP 360(c); 17 C.F.R. § 201.360(c). As such, an ALJ's factual and legal findings and any sanctions issued certainly have a "final" effect with respect to their impact on respondent, and undoubtedly represent an exercise of "significant authority."

Order Req. Supp. Br. at 3, *In re Timbervest, LLC*, Exchange Act Release No. 4197 (Sept. 17, 2015).

In short, the accountability and the structural integrity guaranteed by the Appointments Clause are nowhere to be found in the Commission's administrative proceeding against Mr. Aesoph and Mr. Bennett. ALJ Foelak's Initial Decision carries the power to, and has in practical effect, irretrievably harmed the careers of Respondents. The Constitution guarantees that Mr. Aesoph and Mr. Bennett not be subject to such significant authority exercised by a mere rank-and-file employee; rather, Mr. Aesoph and Mr. Bennett are entitled to a fair hearing before an ALJ who has been personally vetted and appointed by the President, a court of law, or the head of a department.

The instant administrative proceeding is thus tainted by a structural error that requires vacatur of the underlying proceeding and ALJ Foelak's Initial Decision. This error requires reversal "regardless of whether prejudice can be shown." *See Intercollegiate v. Broad. Sys., Inc. v. Copyright Royalty Bd.,* 796 F.3d 111, 123-24 (D.C. Cir. 2015) ("In our prior decision in this matter, we concluded that the appointment of the Judges constituted error under the Appointments Clause, and . . . vacated their decision without any consideration of whether that error was harmless."). Further, the Commission cannot remedy the constitutional violation simply by reviewing *de novo* the administrative record. That record itself is inextricably tainted by the unconstitutional process—ALJ Foelak made countless discretionary and non-discretionary decisions over the course of the 18-month proceeding. The proceeding itself is invalid. *See Ryder v. United States.*, 515 U.S. 177, 188 (1995) ("Petitioner is entitled to a hearing before a properly appointed panel of that court."); *see also Nguyen v. United States*, 539 U.S. 69, 80-81 (2003) (finding it "inappropriate to . . . assess the merits" because the improperly appointed

judge lacked the power to participate). Indeed, resolving the violation by a *de novo* review in these circumstances would allow all such arrangements to escape judicial scrutiny. *Intercollegiate*, 796 F.3d at 123 ("If the process of final *de novo* review could cleanse the [Appointments Clause] violation of its harmful impact, then all such arrangements would escape judicial review." (internal quotation marks omitted) (alteration in original)).

CONCLUSION

As set forth above, ALJ Foelak was appointed in violation of the Appointments Clause. As a result, the administrative proceeding against Messrs. Aesoph and Bennett and the Initial Decision issued by ALJ Foelak were tainted with the resulting structural constitutional error and must be vacated.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

On October 21, 2015, the foregoing RESPONDENTS' JOINT SUPPLEMENTAL BRIEF IN SUPPORT OF APPEAL and three copies were hand delivered to the following party:

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On October 21, 2015, the foregoing RESPONDENTS' JOINT SUPPLEMENTAL BRIEF IN SUPPORT OF APPEAL was delivered to the following via electronic and U.S. Mail:

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On October 21, 2015, the foregoing RESPONDENTS' JOINT SUPPLEMENTAL BRIEF IN SUPPORT OF APPEAL was served upon counsel for the following party by electronic mail, pursuant to the parties' agreement:

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