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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255

In the Matter of

John Thomas Capital Management Group LLC d/b/a/ Patriot28 LLC,
George R. Jarkesy, Jr.,
John Thomas Financial, Inc., and
Anastasios "Tommy" Belesis,

Respondents.

DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENTS' MOTION TO ADDUCE ADDITIONAL EVIDENCE AND CONDUCT FURTHER DISCOVERY

Respondents have filed a request seeking leave to adduce additional evidence relating to claims that: (1) the pending proceeding violates due process because the presiding administrative law judge ("ALJ") may have been biased; (2) the Commission has prejudged the issues in this case and therefore cannot render an impartial decision on Respondents' liability; and (3) the appointment of ALJ Carol Foelak, who presided over the administrative proceeding, violated the Appointments Clause of the Constitution. Mot. 4-12. Respondents also seek to submit additional briefing on their Appointments Clause claim. Mot. 12-13.

The Division of Enforcement ("Division") does not oppose Respondents' request for briefing on the Appointments Clause challenge. Should the Commission find that such briefing would aid its decision, the Division requests that both parties be permitted to submit briefs according to a schedule that the Commission deems appropriate. As to Respondents' requests to

adduce additional evidence, the Division takes no position on their requests to introduce: (1) a May 6, 2015 *Wall Street Journal* article containing comments attributed to Lillian McEwen, a former Commission ALJ; (2) a transcript of proceedings in *Tilton v. SEC*, No. 15-cv-2472 (S.D.N.Y. May 11, 2015); (3) a May 12, 2015 *Wall Street Journal* article containing comments attributed to George Canellos, a former Division co-director; and (4) an order granting preliminary injunctive relief in *Hill v. SEC*, No. 1:15-cv-1801 (N.D. Ga. June 8, 2015). The Division opposes Respondents' remaining requests for the reasons set forth below.

I. Discovery relating to Respondents' claim of ALJ bias is inappropriate.

Respondents seek multiple categories of discovery (including documents and testimony) relating to their claim that ALJ Foelak may have been biased "for the Division and against Respondents." Mot. 5, 10-12 (bullets 1-10 and 14).[1] Such discovery is inappropriate and unwarranted because Rule 111(f) of the Commission's Rules of Practice contains an established procedure for allowing parties to raise concerns about the presiding ALJ: a motion for recusal. 17 C.F.R. § 201.111(f). That Rule gives a hearing officer of an administrative proceeding the authority to "recus[e] him or herself upon motion made by a party or upon his or her own motion." *Id.* Moreover, in general, when a party seeks to recuse an adjudicator such as a judge, a recusal motion must be directed to *that judge* for a determination in the first instance. *E.g.*, *United States v. Torkington*, 874 F.2d 1441, 1446 (11th Cir. 1989) (the presiding "judge has the initial responsibility to recuse himself from a case"); *Keating v. Office of Thrift Supervision*, 45 F.3d 322, 326-27 (9th Cir. 1995) (the recusal procedure "reflects an underlying policy that a decisionmaker asked to recuse himself or herself should be presented with the basis for the

[1] Although Respondents have previously moved to recuse the *Commission* on prejudgment grounds (*see John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 74419, 2015 WL 883121, at *1 (Mar. 3, 2015)), they have not moved to recuse the presiding ALJ.

request"). Therefore, should the Commission determine to allow Respondents to pursue further their claim that ALJ Foelak may have been biased, the Division requests that it do so consistent with the above-described procedures, rather than through discovery. This could be accomplished by remanding the case to ALJ Foelak for the sole, limited purpose of allowing Respondents, should they so choose, to file a motion under Rule 111(f) raising arguments related to the alleged, newly discovered evidence (*i.e.*, the statements reported in the May 6, 2015 *Wall Street Journal* article), and allowing ALJ Foelak the opportunity to rule on that motion. The Division requests that should such a remand occur, it proceed on an expedited basis consistent with the Commission's December 11, 2014 order granting expedited review of this case.

II. Discovery relating to Respondents' Appointments Clause challenge is irrelevant and unnecessary.

Respondents seek documents and testimony "pertaining to [ALJ Foelak's] appointment as an SEC ALJ" on the theory that such discovery is necessary to determine whether her appointment violated Article II, Section 2, Clause 2 of the Constitution. Mot. 11-12, bullets 11 and 15. But the requested discovery is unnecessary because, as Respondents point out, the government has previously acknowledged in the *Tilton* federal case that, consistent with her status as an agency employee and not a constitutional officer, ALJ Foelak was not hired with the approval of the Commissioners. *See* Mot. 2-3. The Division also is willing to stipulate in this matter that ALJ Foelak was not hired with the approval of the Commissioners. This stipulation contains the only factual information legally relevant to the ALJ hiring process that Respondents need to pursue their Appointments Clause challenge. The other information relating to ALJ

Foelak's hiring sought by Respondents is unnecessary, as it is irrelevant to and would not advance any of Respondents' claims.[2]

III. Discovery relating to Respondents' claim regarding the "appearance of injustice of the administrative forum" is unnecessary and unwarranted.

Respondents seek discovery of "[d]ocuments . . . discussing or relating to any 'appearance of injustice' of the SEC administrative forum." Mot. 11, bullet 12. This request appears to relate to their claim that it is improper for the Commission to both authorize enforcement proceedings and determine whether the law has been violated because (in their view) the Commission therefore necessarily "prejudge[s]" the issues in the case. *See* Mot. 7. For multiple reasons, the Division opposes that request.

To begin with, Respondents' argument is, at its core, a broad-based, speculative attack on the very structure of the Commission's administrative enforcement system; indeed, Respondents fail to identify any actual documents or categories of documents that they believe would bear on this claim. *See* Mot. 11, bullet 12. The Commission should not permit this "unwarranted fishing expedition" by Respondents to find support for their ill-defined theory that the Commission's entire administrative enforcement scheme is improper. *See Bastin v. Fed. Nat'l Mortg. Ass'n*, 104 F.3d 1392, 1396 (D.C. Cir.1997) (denial of discovery is appropriate where it would amount

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[2] Others who have challenged the Commission's administrative process under Article II have recognized as much. *E.g.*, Respondents' Response to Division's Opposition to Motion to Adduce Additional Evidence at 1, *optionsXpress, Inc.*, File No. 3-14848 (July 13, 2015) (explaining that the Division's willingness to stipulate that the presiding ALJ was not hired with the approval of the individual Commissioners "has satisfied Respondents' discovery request" and that respondents intended to move on this basis to submit additional briefing on their Appointments Clause claim); Pl.'s Memo. of Law In Support of Mot. for TRO and Prelim. Inj. at 13, *Timbervest, LLC et al. v. SEC*, No. 15-cv-2106 (S.D.N.Y. June 12, 2015) (basing Appointments Clause claim solely on fact that the assigned ALJ "was not hired through a process involving the approval of the individual members of the Commission"). The district court in *Tilton* reached the same conclusion. Order at 16, *Tilton v. SEC*, 15-cv-2472-16 (S.D.N.Y. June 30, 2015) (rejecting plaintiff's contention that additional discovery was necessary to advance her Appointments Clause claim, noting statement by plaintiff's counsel during oral argument that "I don't think that your Honor has to deal with factual issues").

to "nothing more than a fishing expedition" because the appellant is "unable to offer anything but rank speculation").

Moreover, Respondents' argument is itself meritless. The Supreme Court has long rejected "[t]he contention that the combination of investigative and adjudicative functions necessarily creates an unconstitutional risk of bias in administrative adjudication." *Withrow v. Larkin*, 421 U.S. 35, 47 (1975); *see also, e.g., Shaughnessy v. United States ex rel. Accardi*, 349 U.S. 280 (1955); *Richardson v. Perales*, 402 U.S. 389, 410 (1971). Rather, as the Court has made clear, due process challenges to the blending of prosecutorial and adjudicative functions in administrative agencies "must overcome a presumption of honesty and integrity in those serving as adjudicators" and must "convince that, under a realistic appraisal of psychological tendencies and human weakness, conferring investigative and adjudicative powers on the same individuals poses . . . a risk of actual bias or prejudgment." *Withrow*, 421 U.S. at 47. The appropriate inquiry is therefore not whether the Commission plays a role at multiple stages of this administrative proceeding but rather whether the Commissioners' minds are "irrevocably closed" to the evidence, *FTC v. Cement Institute*, 333 U.S. 683, 701 (1948), or "the risk of unfairness" in the proceeding is otherwise "intolerably high," *Greenberg v. Board of Governors of Federal Reserve System*, 968 F.2d 164, 167 (2d Cir. 1992) (internal quotation marks omitted).

Respondents, moreover, have already raised, and the Commission repeatedly declined to review, claims that the Commissioners' minds are in fact irrevocably closed to the evidence in this case. *See John Thomas Cap. Mgmt. Grp. LLC*, Exchange Act Release No. 71415, 2014 WL 294551 (Jan. 28, 2014). The Commission denied Respondents' petition for interlocutory review of an ALJ order rejecting claims that the Commission had necessarily prejudged Respondents' liability because it had made findings applicable to Respondents' co-respondents when accepting

an offer of settlement from those parties. *Id.*; *see also John Thomas Capital Mgmt. Grp. LLC*, Exchange Act Release No. 73375, 2014 WL 5282156, at *1 (Oct. 16, 2014) (reiterating that "no prejudgment of the non-settling respondent's case occurs even though the agency may have acquired some familiarity with the underlying events at another stage of the proceedings involving other respondents").

Accordingly, Respondents' request for materials relating to the "'appearance of injustice' of the SEC administrative forum" should be denied.

IV. Documents "describing how the decision was made to prosecute Respondents in the SEC administrative forum in lieu of an action brought in federal district court" are not discoverable because they are covered by multiple privileges.

To the extent Respondents seek additional discovery relating to the Commission's policy and decision-making process for bringing this action in an administrative proceeding rather than before a district court (*see* Mot. 11, bullet 13), the Division opposes that request. Respondents have not explained how such request is relevant to any of their arguments; rather, they assert only "the need to conduct additional discovery to explore the accusations made in the WSJ Articles[.]" Mot. 10. But this purported "need" to flesh out "accusations" made in the press (*id.*) again "amount[s] to nothing more than a fishing expedition" and does not warrant further discovery (*Bastin*, 104 F.3d at 1396). Moreover, and more importantly, the materials Respondents seek are protected by the attorney-client, deliberative-process and work product privileges. Respondents' request for this discovery therefore should be denied.

1. *Attorney-client privilege:* The attorney-client privilege shields confidential communications made between attorneys and their clients when the communications are made for securing legal advice or services. *In re Sealed Case*, 737 F. 2d 94, 98-99 (D.C. Cir. 1984). The privilege applies to "legal advice, legal analysis, and recommendations" that an agency

lawyer provides to the agency. *Linder v. Calero-Portocarrero*, 183 F.R.D. 314, 324 (D.D.C. 1998). That includes SEC action memoranda as well as any other documents containing Commission attorneys' analysis and legal advice regarding whether and where to bring an enforcement action. *See, e.g.*, *United States v. Peitz*, No. 01 CR 852, 2002 WL 31101681, at *9 (N.D. Ill. Sep. 20, 2002); *accord*, *Somers*, 2013 WL 4045295, at *2; *Merkin*, 2012 WL 2568158, at *1 (action memorandum is "classic attorney-client privilege material"). Critically, the privilege "'cannot be overcome by a showing of need.'" *United States v. Gonzalez*, 669 F.3d 974, 981 (9th Cir. 2012) (quoting *Admiral Ins. Co. v. U.S. Dist. Ct. of Ariz.*, 881 F.2d 1486, 1494 (9th Cir. 1989)); *see also, e.g.*, *Nixon v. Sirica*, 487 F.2d 700, 746 (D.C. Cir. 1973) (MacKinnon, J., concurring in part and dissenting in part) ("[The] attorney-client privilege[] may be invoked . . . regardless of the claimed necessity for disclosing the evidence.").

2. *Deliberative-process privilege:* The deliberative-process privilege protects the decision-making processes of government agencies and encourages the frank discussion of legal and policy issues by ensuring that agencies are not forced to operate in a fishbowl. *Mapother v. DOJ*, 3 F.3d 1533, 1537 (D.C. Cir. 1993); *Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 866 (D.C. Cir. 1980) (privilege extends to documents that are "predecisional" and "deliberative," including "recommendations, draft documents, proposals, suggestions, and other subjective documents which reflect the personal opinions of the writer rather than the policy of the agency"). As relevant here, the privilege shields governmental deliberations concerning whether to initiate litigation or to pursue a particular course of action in litigation. *E.g.*, *United States v. Farley*, 11 F.3d 1385, 1389 (7th Cir. 1993) (referral memoranda from FTC staff to the Department of Justice and staff memoranda to senior agency officials with recommendations, legal interpretations and drafts of litigation documents are exempt under the deliberative process

privilege); *SEC v. Somers*, No. 3:11-cv-00165, 2013 WL 4045295, at *2 (D. Kan. Aug. 8, 2013) (deliberative-process privilege, among others, "clearly cover[s]" a Commission action memorandum and associated documents addressing whether to bring an enforcement action); *SEC v. Merkin*, No. 11-23585-civ, 2012 WL 2568158, at *7 (S.D. Fla. June 29, 2012) (action memorandum protected by deliberative-process privilege). Because Respondents seek "documents . . . describing how the decision was made to prosecute Respondents," including how the Commission determined to proceed in an "administrative forum in lieu of . . . federal district court" (Mot. 11, bullet 13), the documents they request fall squarely within the privilege.[3]

3. *Work-product doctrine:* The attorney work-product privilege protects from disclosure "documents prepared in anticipation of foreseeable litigation, even if no specific claim is contemplated." *Schiller v. NLRB*, 964 F. 2d 1205, 1208 (D.C. Cir. 1992). Such documents may include "the files and the mental impression of an attorney . . . reflected of course, in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways." *Hickman v. Taylor*, 329 U.S. 495, 510-11 (1947). Here, any documents related to the decision to bring an action in a specific forum or to pursue an action at all would necessarily have been prepared in anticipation of litigation, and therefore plainly are covered by the privilege. *See Somers*, 2013 WL 4045295, at *2 (an SEC action memorandum and associated documents "are created in anticipation of litigation, and at the very least, the attorney work product privilege protects them"); *accord Merkin*, 2012 WL 2568158, at *1; *SEC v. Nacchio*, No. 05-cv-00480-MSK-CBS, 2007 WL 219966, at *7 (D. Colo.

[3] The deliberative-process privilege may be overcome in certain circumstances if the government's deliberations or the government's alleged misconduct are themselves at issue, but to properly invoke these exceptions Respondent must make a "colorable showing" of impropriety; mere suspicion of "improper motivations" is insufficient. *Hinckley v. United States*, 140 F.3d 277, 285–86 (D.C. Cir. 1998). Here, Respondents have made no such showing.

Jan. 25, 2007) (documents including action memorandum privileged); *SEC v. Cavanaugh*, No. 98 Civ. 1818(DLC), 1998 WL 132842, at *2 (S.D.N.Y. Mar. 23, 1998) (documents privileged where prepared by attorneys determining whether to recommend enforcement action); *see also Chau v. SEC*, --- F. Supp. 3d ---, No. 14-cv-1903, 2014 WL 6984236, *11 (S.D.N.Y. Dec. 11, 2014) (appeal pending) (citing with approval decision by Commission ALJ to reject substantially similar effort to obtain discovery concerning the Commission's internal deliberative process to institute an administrative proceeding).[4]

CONCLUSION

For the foregoing reasons, the Commission should deny Respondents' requests to adduce additional evidence beyond the specified *Wall Street Journal* articles, transcript of proceedings in *Tilton v. SEC*, and order granting temporary injunctive relief in *Hill v. SEC*.

This 20th day of July, 2015.

DIVISION OF ENFORCEMENT

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[4] Although the work-product privilege is qualified, *Admiral Ins. Co.*, 881 F.2d at 1494, here there is no basis for overriding this privilege. Attorney "opinion work product"—material reflecting a lawyer's "mental impressions, conclusions, or legal theories," *Blizzard*, A.P. File No. 3-10007, 2002 WL 662783, at *4 (Apr. 23, 2002)—is "virtually undiscoverable," *Director, Office of Thrift Supervision v. Vinson & Elkins, LLP*, 124 F.3d 1304, 1307 (D.C. Cir. 1997); *Upjohn Co. v. United States*, 449 U.S. 383, 400 (1981) (work product "revealing the attorney's mental processes" receives "special protection"). And "[a] party can discover fact work product upon showing a substantial need for the materials and an undue hardship in acquiring the information any other way." *Vinson & Elkins, LLP*, 124 F.3d at 1307. Respondents have not made such a showing.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255

In the Matter of	:
	:
JOHN THOMAS CAPITAL MANAGEMENT GROUP, LLC, d/b/a PATRIOT 28, LLC, and	:
	:
GEORGE R. JARKESY JR,	:
	:
Respondents.	:
	:

CERTIFICATE OF SERVICE

I certify that on July 20, 2015, I have served the Division's Opposition to the Respondents' Motion to Adduce Evidence by overnight mail and/or e-mail on the following:

Brent J. Fields, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E., Mail Stop 3628
Washington, D.C. 20549

The Honorable Carol Fox Foelak
Administrative Law Judge
U.S. Securities and Exchange Commission
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UNITED STATES
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July 20, 2015

VIA UNITED PARCEL SERVICE

Brent Fields, Secretary
Office of the Secretary
Securities and Exchange Commission
100 F Street N.E., Mail Stop 3628
Washington, DC 20549

Re: John Thomas Capital Management Group LLC et. al, Admin. Proc. File No. 3-15255

Dear Mr. Fields:

On behalf of the Division of Enforcement in the above-captioned proceeding, and in accordance with Rule of Practice 152(d), I submit for filing an original and three copies of the Division of Enforcement's Opposition to Respondents' Motion to Adduce Additional Evidence and Conduct Further Discovery.

Respectfully submitted,

Gladwin V. Murray
Paralegal

cc: The Honorable Carol Fox Foelak (by United Parcel Service ("UPS"))

Karen Cook, Esq., Karen Cook PLLC (by UPS)
Counsel with S. Michael McColloch, Steven G. Gleboff and Stanley Sporkin for Respondents George R. Jarkesy Jr. and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC

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